





ATTENDEES: (Cont'd.)

Panel 14:

On behalf of American Council of Life Insurers:

JAMES SZOSTEK, Vice President Taxes & Retirement  
Security

On behalf of Pension Rights Center:

MARIA FREESE, Senior Policy Advisor

On behalf of TIAA-CREF:

EDWARD MOSLANDER, Senior Managing Director

Panel 15:

On behalf of Association for Advanced Life  
Underwriting:

CALEB J. CALLAHAN, Senior Vice President, Chief  
Marketing Officer  
ValMark Securities Corporation

On behalf of Farmers Insurance and Farmers  
Financial Solutions:

JOE WIMPEE, Farmers Agent

On behalf of National Active and Retired Federal  
Employees Association:

RICHARD THISSEN, National President

Panel 16:

On behalf of American Bankers Association:

GERALD P. CLEARY, Senior Vice President  
Northern Trust Company

On behalf of Center for American Progress:

JOE VALENTI, Director of Consumer Finance

ATTENDEES: (Cont'd)

On behalf of Russell Investments:

JEAN-DAVID LARSON, Director, Regulatory and  
Strategic Initiatives

Panel 17:

On behalf of American Retirement Association:

MARCY SUPOVITZ, President-Elect

On behalf of The SPARK Institute, Inc.:

TIM ROUSE, Executive Director

Panel 18:

On behalf of Americans for Financial Reform:

DR. MARCUS STANLEY, Policy Director

On behalf of Financial Services Institute:

DALE E. BROWN, President and Chief Executive  
Officer, FSI

W. MARK SMITH, Sutherland Asbill & Brennan, LLP

On behalf of Indexed Annuity Leadership Council  
(IALC):

JIM POOLMAN, Executive Director

Panel 19:

On behalf of CFA Institute:

LINDA RITTENHOUSE, Director, Capital Markets  
Policy-Americas

On behalf of Committee for the Fiduciary Standard:

KATHLEEN M. McBRIDE, Chair

On behalf of Davis & Harman, LLP:

KENT A. MASON

ATTENDEES: (Cont'd)

Panel 20:

On behalf of Committee of Annuity Insurers:

MICHAEL L. HADLEY, Davis & Harman, LLP  
JOSEPH F. McKEEVER, Davis & Harman, LLP

Empower Retirement:

EDMUND F. MURPHY, III, President

On behalf of Capital Group Companies:

JASON BORTZ

I N D E X

<u>STATEMENT OF</u>	<u>PAGE</u>
JAMES SZOSTEK, VICE PRESIDENT TAXES & RETIREMENT SECURITY, AMERICAN COUNCIL OF LIFE INSURERS	690
MARIA FREESE, SENIOR POLICY ADVISOR, PENSION RIGHTS CENTER	699
EDWARD MOSLANDER, SENIOR MANAGING DIRECTOR, TIAA-CREF	708
CALEB J. CALLAHAN, SENIOR VICE PRESIDENT, CHIEF MARKETING OFFICER, VALMARK SECURITIES CORPORATION	748
JOE WIMPEE, FARMERS AGENT, FARMERS INSURANCE AND FARMERS FINANCIAL SOLUTIONS	759
RICHARD THISSEN, NATIONAL PRESIDENT, NATIONAL ACTIVE AND RETIRED FEDERAL EMPLOYEES ASSOCIATION	769
GERALD P. CLEARY, SENIOR VICE PRESIDENT NORTHERN TRUST COMPANY, AMERICAN BANKERS ASSOCIATION	803
JOE VALENTI, DIRECTOR OF CONSUMER FINANCE, CENTER FOR AMERICAN PROGRESS	812
JEAN-DAVID LARSON, DIRECTOR, REGULATORY AND STRATEGIC INITIATIVES, RUSSELL INVESTMENTS	819
MARCY SUPOVITZ, PRESIDENT-ELECT, AMERICAN RETIREMENT ASSOCIATION	854
TIM ROUSE, EXECUTIVE DIRECTOR, THE SPARK INSTITUTE, INC.	862
JIM POOLMAN, EXECUTIVE DIRECTOR, INDEXED ANNUITY LEADERSHIP COUNCIL (IALC)	902
DALE E. BROWN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FINANCIAL SERVICES INSTITUTE	909
W. MARK SMITH, SUTHERLAND ASBILL & BRENNAN, LLP	912
DR. MARCUS STANLEY, POLICY DIRECTOR, AMERICANS FOR FINANCIAL REFORM	917

I N D E X

<u>STATEMENT OF</u>	<u>PAGE</u>
LINDA RITTENHOUSE, DIRECTOR, CAPITAL MARKETS POLICY-AMERICAS, CFA INSTITUTE	950
KATHLEEN M. MCBRIDE, CHAIR, COMMITTEE FOR THE FIDUCIARY STANDARD	956
KENT A. MASON, DAVIS & HARMAN, LLP	965
MICHAEL L. HADLEY, DAVIS & HARMAN, LLP	998
EDMUND F. MURPHY, III, PRESIDENT, EMPOWER RETIREMENT	1007
JASON BORTZ, CAPITAL GROUP COMPANIES	1014

P R O C E E D I N G S

(9:01 a.m.)

1  
2  
3 MR. HAUSER: Okay. If everyone could turn  
4 off their cell phones and find their seats? It does  
5 seem like the crowds are going down a little bit. I  
6 actually think that's a good sign for everyone's  
7 mental status.

8 As in the day's before, let me just give you  
9 a few of the logistics sorts of things. Once again,  
10 I'm still Tim Hauser, Deputy Assistant Secretary for  
11 Program Operations. This hearing is being broadcast  
12 via streaming video, which, you know, go to  
13 [www.dol.gov\live](http://www.dol.gov/live), backslash live.

14 The notice was published in the *Federal*  
15 *Register* on June 18 with an invitation for folks to  
16 testify. The public comments submitted on the  
17 proposal, requests to testify and a full agenda for  
18 the hearing can be found on our website. We're going  
19 to start again tomorrow at 9 a.m. We have 25 panels  
20 that we're hearing from. We've heard from 13 so far  
21 and so this is Panel No. 14 that's up here.

22 Panelists will be allowed 10 minutes each to  
23 present your testimony. Please try to stick to that.

24 We just have so many people who wanted to speak about  
25 this and would like to get through in a reasonable

1 amount of time. Each of you will get to testify  
2 first, and then the government panel will ask  
3 questions. We won't accept questions from the  
4 audience.

5 We are, as I've said each and every day,  
6 very interested in developing the public record as  
7 fully as possible so we're going to listen carefully  
8 and try to ask questions based on what we hear and  
9 thoughts that spring into our head, but, you know,  
10 those thoughts may not have anything to do with what  
11 the final rule looks like, so please don't draw any  
12 inferences based on our phrasing of a question.

13 The hearing is being transcribed. The  
14 hearing transcript will be made available to the  
15 public on our website hopefully within about two weeks  
16 after the close of the hearing. It could be longer.  
17 It could be shorter. And if you could just as you  
18 testify, if you could remember to identify yourself  
19 and the organization you're affiliated, if any.  
20 Please again limit your remarks to 10 minutes, and for  
21 the benefit of our reporter and for the cameras if you  
22 could speak into the microphone. That's just critical  
23 for us to get a complete and accurate transcript.

24 Let's see. After this hearing we have  
25 already reopened the comment period. We will keep the

1 rulemaking record open for another two weeks, you  
2 know, after the hearing transcript is posted. Again,  
3 all public comments and written testimony will be made  
4 available on our website.

5 Our hope/plan is to break for lunch at 1:15.

6 I know there's a temptation to get up at 12:15 and go  
7 for lunch, but there will be one more panel at that  
8 point, so stick around.

9 In the event of an emergency, which I'm  
10 hoping will not occur, an alarm will sound. There are  
11 two types of alarms. A long, loud continuous tone  
12 means we have to evacuate, get out of the building.  
13 An intermittent tone followed by a public address  
14 announcement means that we need to shelter in place.  
15 In either event, we have a crowd manager -- two crowd  
16 managers -- who have yellow hats and vests, and they  
17 will help you.

18 Do not plug laptops, phones, other devices  
19 into the sockets on the wall. We don't want anyone to  
20 trip. And again, please make sure your cell phones  
21 are turned off or silenced, which reminds me, and now  
22 I think we're ready to go when you are.

23 MR. SZOSTEK: Good morning. My name is  
24 James Szostek. I'm Vice President of Taxes &  
25 Retirement Security at the American Council of Life

1 Insurers. ACLI is a trade organization representing  
2 approximately 300 member life insurance companies  
3 operating in the United States and abroad.

4           Seventy-five million families rely on our  
5 members' products for financial and retirement  
6 security, products such as life insurance, annuities,  
7 long-term care and disability income insurance.  
8 Workers obtain these products through employer  
9 sponsored welfare benefit plans and retirement plans  
10 such as the 401(k). These products are also available  
11 to individuals through life insurance agents and other  
12 financial professionals.

13           We applaud the Administration's work in  
14 bringing annuities into focus. In 2010, the  
15 Department, along with the Treasury and the IRS,  
16 gathered important information about ways the agencies  
17 could further facilitate access to and information  
18 about the use of annuities. Last year, Treasury and  
19 the IRS cleared the way for the use of longevity  
20 annuities and qualified plans and IRAs.

21           The agencies have helped to clarify how  
22 annuities can be embedded within investment options,  
23 and we understand the Department is exploring how  
24 401(k) benefit statements could be improved by  
25 illustrating the value of participant account balances

1 as monthly income for life. We agree that these steps  
2 will help to improve 401(k) plans for savers and  
3 retirees.

4 ACLI and its members support greater access  
5 to annuities and 401(k)s and continued access to  
6 annuities through IRAs. We also support greater  
7 access to workplace savings plans and welfare benefit  
8 products, and we support sound regulation that  
9 promotes good business practices that serve the best  
10 interest of savers and retirees.

11 However, we're concerned that absent  
12 significant changes this proposed rule will frustrate  
13 the formation of new small business savings plans,  
14 drive financial professionals away from small balance  
15 investors. Low to moderate income workers will lose  
16 key human interactions that encourage sufficient  
17 savings that educate workers on investment and  
18 investment strategies. The proposed regulation will  
19 limit access to important welfare benefit plan income  
20 protections and severely restrict access to an  
21 education about annuities.

22 This proposal needs material changes. Our  
23 comment letter details the changes necessary to ensure  
24 that retirement savers and small businesses continue  
25 to have access to savings arrangements and guaranteed

1 lifetime income products. As the Department is well  
2 aware, annuities offer 401(k) retirees a way to  
3 supplement social security and receive additional  
4 income guaranteed to last throughout their retirement,  
5 a personal pension if you will.

6 It may seem counterintuitive, but a key risk  
7 for retirees is the blessing of a long life. Known as  
8 longevity risk, it is all too real a threat of one  
9 outliving their savings and it's growing. A Nobel  
10 Prize laureate has suggested that about half the  
11 people who are currently between the ages of 25 and 35  
12 years old today will live to be 100. It's estimated  
13 that each and every day between now and 2030, 10,000  
14 baby boomers will reach the age of 65.

15 With this in mind, it is important that the  
16 Department consider the good work life insurers do to  
17 encourage small businesses to establish workplace  
18 savings plans, to engage savers and retirees on the  
19 benefits of using a portion of their savings to secure  
20 retirement income with an annuity. The Department's  
21 rule should promote this alignment of interest between  
22 life insurers, workers and retirees.

23 Everyone benefits when there are more  
24 workplace pension savings and welfare benefit plans,  
25 when savings rates improve, when service providers

1       intervene to discourage leakage to preserve savings  
2       for retirement and when there is access to an  
3       education about the key role annuities can play in  
4       retirement planning.

5                 Seniors need the income protections  
6       annuities provide. Annuities are the sole means  
7       available in the marketplace today to secure income  
8       for life. Savers and retirees learn about the  
9       benefits of annuities from financial professionals.  
10       Continued access to information and education  
11       regarding annuities is consistent with the  
12       Administration's efforts to facilitate access to  
13       lifetime income.

14                 Today, too few 401(k) plans offer annuities.

15       In most cases, to access guaranteed lifetime income  
16       retirees must roll over to an IRA. But how will they  
17       know to do that? As the Department is aware, much has  
18       been written about the annuity puzzle. Given the  
19       benefits of annuitization, why don't more people  
20       choose annuities?

21                 First, annuities are not well known by the  
22       general public. The Department's work to include  
23       lifetime income illustrations and participant benefit  
24       statements would be helpful here.

25                 Second, research indicates that people

1 underestimate the value of the annuity proposition.  
2 They have trouble understanding the value of  
3 guaranteed payments given the cost and fees that are  
4 changed. This is why it is common to hear that  
5 annuities are sold, but not bought.

6 Today, financial professionals introduce  
7 savers and retirees to annuities. They explain the  
8 value proposition. They explain the variety of income  
9 options available from traditional immediate annuities  
10 where you purchase a guaranteed stream for a single  
11 premium to deferred annuities with fixed returns and  
12 variable annuities that offer market returns combined  
13 with a range of meaningful guaranteed options to  
14 provide benefits for life and benefits to loved ones.

15 As one would expect, these discussions take  
16 time and can stretch over many months. Given the  
17 challenges, it should surprise no one that  
18 compensation paid to financial professionals for the  
19 sale of annuities differ from that of other investment  
20 products. The buy and hold nature of the product make  
21 the customary practice of commission-based  
22 compensation the most sensible way to pay for these  
23 services.

24 Thus, the dilemma. The focus of the  
25 proposed regulation is the elimination of financial

1 conflicts, that is conflicts that exist due to  
2 differences in compensation between the sale of one  
3 product over that of another. ACLI members are  
4 greatly concerned that as currently drafted the  
5 proposal will drive financial firms to move to  
6 levelize compensation arrangements in a way that will  
7 no longer appropriately compensate financial  
8 professionals for the sale of annuities and other  
9 insurance products.

10 This will lead to a significant decrease in  
11 the availability of these important lifetime income  
12 products. For example, the best interest contract  
13 exemption increases legal exposure while failing to  
14 provide the certainty firms need to transact business  
15 under ERISA. How will they know when compensation is  
16 reasonable? When the Courts decide?

17 Without a workable exemption, financial  
18 professionals must exclude variable annuities from  
19 discussion regarding a saver's or a retiree's IRA.  
20 Variable annuities are an important option selected by  
21 many for its combination of lifetime income  
22 guarantees, investment and withdrawal flexibility.  
23 Excluding variable annuities leaves savers and  
24 retirees with an incomplete picture of lifetime income  
25 options available in the marketplace.

1           The proposal will also prevent insurers from  
2 selling other annuities directly to consumers. The  
3 proposal's affiliate rule would treat the insurer as a  
4 fiduciary, yet the proposed transaction exemptions for  
5 annuities does not cover revenues earned by the  
6 insurer. As a result, the public will have less  
7 access to and information about these important  
8 retirement products. That would not be in the best  
9 interest of retirees.

10           Let me turn to savings. In order to  
11 purchase an annuity, workers need to save. The  
12 proposal as drafted will frustrate the formation of  
13 savings plans for workers employed by small  
14 businesses. Under the proposal, life insurers and  
15 financial professionals will no longer be permitted to  
16 encourage small business owners to establish workplace  
17 savings plans. The proposal denies small business  
18 owners access to product sales, and it denies  
19 fiduciaries access to the best interest contract  
20 exemption for the sale of products to 401(k) plans.

21           Under the proposal, small business owners  
22 must take the initiative to encourage themselves to  
23 establish a savings plan for their workers. They must  
24 expend their own resources to hire a third party  
25 fiduciary to assist them. This is unrealistic.

1 Today's small business retirement plan coverage is a  
2 challenge. Absent material changes, this proposal is  
3 a direct threat to the financial well being of so many  
4 workers, many of whom earn low to moderate wages.

5 Savers, retirees, insurers and other  
6 financial professionals need rules that foster a  
7 robust marketplace. The proposal's counterparty  
8 exception relies on fair and transparent disclosure  
9 for this. The sales exception should be extended to  
10 sales of insurance products to any and everyone. If  
11 Congress intended for the ordinary sales suggestion to  
12 be suggested to a fiduciary standard it would have  
13 written different language into the statute.

14 Finally, I note that the title of the  
15 proposal includes the phrase retirement investment  
16 advice. As you've heard, the proposal's use of broad  
17 language can be read to include recommendations  
18 regarding the purchase of welfare benefit products  
19 such as disability income insurance. Our comment  
20 letter includes recommendations to narrow the focus  
21 solely on advice regarding retirement investments.  
22 It's important that the Department make changes that  
23 clearly exclude life, disability, income and long-term  
24 care insurance provided through employer sponsored  
25 welfare benefit plans.

1 Americans need life insurers to encourage  
2 small businesses to offer workplace savings plans and  
3 welfare benefit plans. They need financial  
4 professionals to challenge them to build a nest egg  
5 for retirement. They need access to an education  
6 about annuities to help secure income throughout all  
7 of their retirement. This is where our members'  
8 interests and those of workers and retirees align.

9 ACLI and its members stand ready to work  
10 with the Department to ensure that any regulatory  
11 action serves to protect retirement savers while  
12 continuing to provide them with the essential products  
13 and services, guidance and advice they want and need  
14 to secure for retirement for life.

15 MR. HAUSER: Thank you.

16 MS. FREESE: Good morning. My name is Maria  
17 Freese. I'm a senior policy advisor for the Pension  
18 Rights Center, and I'm also a business partner with  
19 Barbara Kennelly Associates.

20 The Center is a national consumer  
21 organization dedicated exclusively to the protection  
22 and promotion of the retirement security of workers,  
23 retirees and their families. We are very grateful to  
24 the Department for allowing us to participate in the  
25 hearings on this critical retirement issue.

1                   The Center believes the Department of  
2 Labor's proposed regulations on conflicts of interest  
3 in the definition of investment advice pay tribute to  
4 the original language of ERISA and that their  
5 implementation is essential for the enhancement of the  
6 retirement security of America's workers.

7                   I know you've heard a litany of complaints  
8 from various segments of the financial services  
9 industry about how the rules are unworkable and that  
10 middle income Americans and communities of color will  
11 suffer grievous harm if the proposals are implemented.

12                  We at the Center would point out that every single  
13 consumer oriented group with an interest in retirement  
14 security who represents these communities has  
15 expressed support for the proposals, while the  
16 opposition has come exclusively from an industry with  
17 billions of dollars at stake in maintaining the status  
18 quo. We should be wary when the lion claims to  
19 represent the interests of the lamb.

20                  I would also point out that for groups such  
21 as the Pension Rights Center, your proposed  
22 regulations already represent a significant  
23 compromise. Retirement assets are unique, and  
24 Congress has dedicated billions of tax dollars to  
25 encourage workers to save for their retirement, yet

1       there is a \$7.7 trillion retirement income deficit in  
2       this country, which is the gap between what Americans  
3       have saved to date and what they should have saved to  
4       have a reasonable standard of living in retirement.

5               If it were up to us, the Center would not  
6       permit advisors with a conflict of interest to advise  
7       on retirement assets at all, but we've been willing to  
8       acknowledge and accept the need to accommodate the  
9       realities of the current investment landscape. We  
10       believe the Department has hit the sweet spot with  
11       this proposal, finding a middle ground that adequately  
12       protects retirement investors while also accommodating  
13       the reasonable and legitimate concerns of the  
14       financial services industry.

15              We've submitted more extensive written  
16       comments, so my statement will focus on three issues.

17       First, that the inclusion of advice concerning plan  
18       distributions in IRAs is essential; second, that a  
19       facts and circumstances test is appropriate for  
20       determining whether a person rendering investment  
21       advice is a fiduciary; and, third, that the exception  
22       to the regulations are appropriate and well  
23       considered.

24              First, advice concerning distributions in  
25       IRAs must be included. The decision on whether to

1 take a lump sum distribution from a plan can have  
2 profound effects on a person's financial security and  
3 retirement. In some cases the decision to move assets  
4 from a defined contribution plan to an IRA can result  
5 in the retirement saver paying higher fees for the  
6 similar investment assets and can also result in loss  
7 of access to plan investment options that may not be  
8 available in an IRA.

9 The effects of such a decision can be  
10 especially profound in a traditional pension plan  
11 where a participant gives up an annuity benefit or, in  
12 the case of a married participant, a joint survivor  
13 annuity. While there are certainly situations in  
14 which a distribution of benefits from a plan may be  
15 warranted, in the majority of cases such a  
16 distribution will expose the participant to  
17 significant costs.

18 The person providing advice to take a  
19 distribution, on the other hand, typically has strong  
20 financial incentives to recommend taking the  
21 distribution, and this unfortunately can influence the  
22 advice. Our written comments have a paper attached  
23 that demonstrates this point.

24 The financial service industry's arguments  
25 are, to say the least, contradictory. While they

1       insist that knowing the cost of advice will act as a  
2       disincentive to savers, who will forego advice rather  
3       than knowingly pay for it, they suggest that brokers  
4       and other advisors are completely immune to financial  
5       incentives offered to promote certain investment  
6       products.

7                       While the Center is quite confident that  
8       most advisors are concerned about the financial well  
9       being of their clients, we believe it is disingenuous  
10      to claim that they are completely immune to financial  
11      incentives to promote poorly performing investments  
12      with high profit margins. Financial incentives  
13      matter. If they didn't, Congress could eliminate all  
14      tax incentives and no one's behavior would change.

15                      Second, the definition of fiduciary should  
16      not be tied to the existence of an agreement. The  
17      proposed rule states that a person who provides  
18      investment advice is a fiduciary if the advice is  
19      rendered "pursuant to a written or verbal agreement,  
20      arrangement or understanding."

21                      We are concerned that this reference may be  
22      interpreted as requiring bilateral or shared  
23      understanding by both a retirement investor and the  
24      advisor that advice is being directed toward the  
25      advice recipient. This interpretation could send us

1 back to the current regime where a boilerplate  
2 disclosure indicating the advice is not intended to be  
3 relied on exclusively by the investor insulates the  
4 advisor from fiduciary responsibility.

5 We believe that a person offers investment  
6 advice if under the totality of circumstances it  
7 appears that a person is offering advice to another  
8 person regarding an investment or management decision  
9 related to assets of a plan or IRA. This test would  
10 apply regardless of whether there's a bilateral,  
11 common or shared understanding that advice is being  
12 provided.

13 Third, the proposed exceptions and  
14 carve-outs from the new regulation are appropriate and  
15 workable responses to legitimate industry concerns.  
16 The package of new PTEs is meticulously constructed,  
17 and best interest contract exemption succeeds in  
18 mitigating the impact of conflicts while preserving  
19 substantial flexibility for financial institutions to  
20 market their products and compensate those persons who  
21 recommend and sell them.

22 While we strongly support the BIC, we  
23 believe there are ways to strengthen it for consumers.

24 For example, the Department should clearly provide  
25 that the exemption applies to rollover advice provided

1 by either a third party call center or advisors not  
2 affiliated with the plan. While we read the exemption  
3 to clearly cover this advice, we understand some in  
4 the financial services industry have raised questions  
5 about its applicability.

6 The Center also opposes mandatory  
7 arbitration clauses in all situations. However, we  
8 believe mandatory arbitration is especially  
9 inappropriate in disputes involving a plan fiduciary  
10 and a participant or beneficiary in an employer  
11 sponsored plan. Congress provided that one of ERISA's  
12 core purposes was providing ready access to federal  
13 courts, and permitting a mandatory arbitration would  
14 undermine these fundamental protections.

15 We've noted your previous exchanges during  
16 these hearings relating to implementation issues  
17 involving the BIC. We believe that implementing the  
18 BIC is workable. Consumers are used to signing  
19 documents involving a wide variety of transactions,  
20 and the financial services industry is always  
21 adaptable. The Center would endorse sensible  
22 modifications of implementation issues as long as the  
23 integrity of the best interest standard is maintained  
24 and legally enforceable.

25 In relation to the carve-outs identified in

1 the rule, we would make two points. First, we believe  
2 elimination of the sales exception for individuals is  
3 a critically important revision to the 2010 proposal  
4 and must be retained. In our experience, most plan  
5 participants will not be able to discern whether  
6 advice is impartial or conflicted in the context of a  
7 sales presentation and will often assume the advisor  
8 is acting in their best interest.

9 Second, we believe the Department has  
10 correctly drawn the line to preclude identification of  
11 specific products and presentations of an educational  
12 nature. This is key to protecting consumers who often  
13 cannot identify sophisticated sales presentations in  
14 the guise of educational activities.

15 Finally, we want to make a few points on  
16 variable annuities. The Pension Rights Center has  
17 been a strong proponent of lifetime income streams for  
18 retirees in a wide variety of contexts. We've  
19 supported the role that annuities, including some  
20 variable annuities, play in providing retirement  
21 security for America's workers, but we also know the  
22 variable annuities and similar annuity products can be  
23 among the most complicated financial investment  
24 products being marketed to average Americans today.

25 It is virtually impossible for the average

1 person to determine the cost or implications of the  
2 various options available for complex annuity  
3 products. Expecting them to make intelligent  
4 decisions about whether to invest in an annuity and  
5 what features to select when they cannot understand  
6 the cost of the options is simply unrealistic. In  
7 fact, previous industry witnesses have stated that the  
8 sellers of these products themselves cannot  
9 specifically identify these costs.

10 Most Americans will have no choice but to  
11 rely on investment professionals to do the comparisons  
12 for them and to advise them on the best product for  
13 them to invest in. They do this with every  
14 expectation that the advisor will be providing this  
15 advice based on the customer's best interest, and we  
16 strongly advise the agency to make sure that this is  
17 the case.

18 In conclusion, ERISA was designed to ensure  
19 that Americans can build adequate financial security  
20 for that period in their life when they no longer  
21 participate in the workforce and to ensure that the  
22 reasonable expectations are protected. That's why  
23 ERISA is organized around a fiduciary standard, the  
24 highest standard of behavior in law, to eliminate  
25 rather than merely to disclose conflicts of interest.

1 Secretary Perez has made it clear this is the north  
2 star the new rules are pointed toward, and we strongly  
3 agree with this goal. As long as the goal is not  
4 lost, we would support reasonable changes to  
5 facilitate implementation of the new regulations.

6 There's no question the Department of Labor  
7 has worked mightily to construct a regulatory regime  
8 consistent with the purpose of protecting savers while  
9 accommodating legitimate concerns of advisors. The  
10 Department deserves high praise for its efforts today,  
11 and we encourage you now to complete your work  
12 expeditiously as it is essential to the protection of  
13 America's workers. Thank you, and I'm happy to answer  
14 any questions.

15 MR. HAUSER: Thank you. Mr. Moslander?

16 MR. MOSLANDER: Thank you. I am grateful  
17 for this opportunity to share TIAA-CREF's views with  
18 the Department. My name is Ed Moslander. I'm a  
19 senior managing director at TIAA-CREF where I lead  
20 Institutional Client Services.

21 TIAA-CREF is the leading provider of  
22 retirement plan services in the not-for-profit and  
23 higher education markets and a global asset manager  
24 with more than \$869 billion in assets under  
25 management. We were founded nearly a century ago to

1 operate on a not-for-profit basis with the mission to  
2 serve those who serve others and to aid and strengthen  
3 our client institutions.

4 For nearly a hundred years, TIAA-CREF has  
5 helped our clients both to and through retirement, and  
6 putting the customer first has remained a core value  
7 that defines the way we serve our retirement plan  
8 participants and IRA owners. TIAA-CREF strongly  
9 believes that putting the customer first should be the  
10 industry standard. To that end, we applaud the  
11 Department for undertaking this important project.

12 All retirement savers need to know that  
13 their financial institutions and advisors are putting  
14 the retirement savers' interests first. Building on  
15 our strong collaborative working relationship with the  
16 Department, TIAA-CREF submitted a detailed comment  
17 letter outlining certain modifications to the  
18 proposal. All requested to ensure that our retirement  
19 plan participants and IRA owners continue to have  
20 access to the advice and educational resources that  
21 enable them to plan effectively for retirement.

22 In the time I have today I'd like to focus  
23 on two points in our letters. First, I would like to  
24 underscore TIAA-CREF's agreement with the Department  
25 that individualized distribution advice, including

1 whether to receive a lifetime income distribution from  
2 an annuity or to roll over from an employer sponsored  
3 plan to an IRA, should be subject to the very same  
4 fiduciary standards as all other advice. We do,  
5 however, offer some technical recommendations in this  
6 regard. Second, I'd like to highlight our concern  
7 with the proposal's impact on the Department's goal of  
8 fostering lifetime income solutions.

9 Let me begin with distribution advice. As I  
10 mentioned earlier, acting in the client's best  
11 interest is a standard we always strive to follow at  
12 TIAA-CREF, including and especially in a distribution  
13 phase. The same best interest standard ought to be  
14 the industry standard in all contexts.

15 As a provider that helps retirement plan  
16 participants both to and through retirement, we have  
17 seen that many participants are best served by keeping  
18 their assets within the plan until retirement. The  
19 advantages are several. Participants benefit from  
20 ERISA protections and can take comfort that their  
21 employer is required to engage in an extensive due  
22 diligence process when designing the plan menu and  
23 choosing a plan provider.

24 Participants often benefit from  
25 institutional share class pricing, which generally

1 keeps fees lower than retail shares. Plans that  
2 choose TIAA-CREF can provide in-plan, built-in  
3 lifetime income features. This results in higher  
4 annuitization rates and improved retirement outcomes.

5 And participants often benefit from allocating money  
6 over time to fixed annuity contracts with historical  
7 interest crediting rates that can be higher than rates  
8 any new investment can offer.

9 To be sure, TIAA-CREF does not advocate for  
10 one size fits all financial planning solutions. We  
11 agree that sometimes rolling into an IRA will be in  
12 the participant's best interest. For instance, when a  
13 plan participant seeks a guaranteed lifetime income  
14 option, but her plan lacks one, it may be appropriate  
15 for her to roll over some or all of her plan balance  
16 to an IRA that enables her to purchase such an option.

17 We've also seen situations where an advisor  
18 encourages a participant to roll over from a plan to  
19 an IRA without, for instance, understanding that the  
20 new investments have a much different risk and expense  
21 profile, such as when moving from a guaranteed fixed  
22 annuity with a high interest crediting rate to a bond  
23 fund that carries lower interest rates along with  
24 substantial principal risk or from an institutional  
25 mutual fund share class to a retail share class.

1           Many of our plan sponsors have expressed  
2           concern with these practices, and extending the same  
3           fiduciary framework to distribution advice could  
4           ensure each participant's best interest is being  
5           served both to and through retirement. We would,  
6           however, urge the Department to address technical  
7           issues with the proposal's implementation of the best  
8           interest standard.

9           Most critically, the education carve-out  
10          should expressly permit meaningful education about  
11          distribution options. Moreover, we believe that in  
12          all contexts the fiduciary standard should apply only  
13          if investment advice is sufficiently individualized to  
14          form a reasonable basis for reliance by the advice  
15          recipient and should be distinguished from ordinary  
16          marketing or selling activities.

17          It's essential also for fiduciaries to be  
18          given reasonable mechanisms to render advice and  
19          receive customary compensation without running afoul  
20          of the prohibited transaction rules. Finally, we urge  
21          the Department to modify the best interest contract  
22          exemption because as proposed it's unworkable and too  
23          expensive to implement, but I would respectfully refer  
24          the Department to our letter for additional details.

25          I'd like now to turn to the proposal's

1 impact on lifetime income products. TIAA-CREF is a  
2 mission driven company that seeks to provide those who  
3 serve others with income they need in their  
4 retirement. We do this through annuities, both fixed  
5 and variable, and mutual funds. Annuities are  
6 typically important for and in the best interests of  
7 our participants because they are a low cost means of  
8 ensuring that they will never run out of money.

9           Every month we write annuity checks to over  
10 28,000 people over the age of 90. Our actuarial data  
11 support the critical importance of lifetime income  
12 solutions. For a TIAA-CREF participant who reaches  
13 age 65, there's a 50 percent likelihood of reaching 89  
14 and a 25 percent likelihood of reaching 95. If the  
15 participant is married, there's a 75 percent  
16 likelihood that at least one spouse will reach age 89  
17 and a 44 percent chance that at least one spouse will  
18 reach 95.

19           Given our mission, we're grateful that the  
20 Department has undertaken significant efforts in  
21 recent years to promote guaranteed lifetime income,  
22 but unintentionally the proposal risked doing the  
23 opposite. Because annuities are complicated,  
24 sometimes cost more than mutual funds due to both  
25 their income level and lifetime income guarantees and

1 are sold on a proprietary basis, we fear the proposal  
2 will discourage the use of guaranteed lifetime income  
3 solutions.

4 The proposed educational carve-out is so  
5 narrow it could curtail our ability to help plan  
6 participants and IRA owners understand how our annuity  
7 options work. The reality is that while mutual funds  
8 are well and easily understood, annuities are not.  
9 For instance, a recent study we did found that while  
10 61 percent of millennials are willing to participate  
11 in what amounts to an annuity, 72 percent of them  
12 really didn't know what an annuity was.

13 Against this backdrop, the narrowness of the  
14 proposed education carve-out is concerning. Under the  
15 carve-out, education does not include "advice or  
16 recommendations as to specific investment products,  
17 specific investment managers or the value of  
18 particular securities or other property," nor can  
19 education include model portfolios or asset allocation  
20 models that refer to specific investment products  
21 available under a plan regardless of whether the  
22 provider includes a disclaimer stating that other  
23 investment alternatives are available.

24 Without the ability to discuss specific  
25 annuity options, it would be very difficult for us to

1 provide participants and IRA owners with sufficient  
2 context to understand the benefits of annuity products  
3 that guarantee participants will never run out of  
4 money.

5           Given the intricacies of such products, it's  
6 unrealistic to expect a participant in a conversation  
7 with a worksite or call center representative not to  
8 ask how a particular annuity works. A sufficiently  
9 broad education exemption is needed to ensure we can  
10 help participants and IRA owners fully understand  
11 these products. The proposal presents an even more  
12 fundamental threshold question for annuities, which is  
13 whether TIAA-CREF could even continue offering plan  
14 participants our own annuities.

15           The proposal's broad definition of  
16 investment advice, the limited counterparty carve-out,  
17 the narrow definition of education, a best interest  
18 definition that departs from the subtle approach used  
19 in ERISA and the new limits proposed on various  
20 prohibited transaction exemptions, all of them taken  
21 together raise major questions about TIAA-CREF's  
22 ability or any annuity provider's ability to sell  
23 proprietary products.

24           TIAA-CREF only sells proprietary annuity  
25 products. These include the in-plan and individual

1 annuity options through which we provide plan  
2 participants and IRA investors guaranteed lifetime  
3 income. But by inhibiting insurance companies from  
4 exclusively selling their own products, the Department  
5 would only decrease the availability of guaranteed  
6 lifetime income products.

7 To address these issues, we ask the  
8 Department to restore a robust educational carve-out  
9 and make important technical corrections, including  
10 confirming that selling proprietary annuity products  
11 can be consistent with the best interest standard and  
12 qualify for the revised prohibited transaction  
13 exemptions.

14 Thank you for the opportunity to testify,  
15 and I look forward to taking your questions.

16 MR. HAUSER: Thank you. I was remiss at the  
17 start of the day not to introduce my co-panelists, so  
18 I'm going to take a minute and do that. On the end  
19 there looking for his papers is Joe Canary, who's the  
20 head of our Office of Regulations and Interpretations.

21 MR. CANARY: I'm actually turning off my  
22 cell phone.

23 MR. HAUSER: Even worse.

24 MR. CANARY: That's what I figured. I  
25 thought I'd be open about it.

1                   MR. HAUSER: Lyssa Hall, the head of our  
2 Office of Exemption Determinations, and Chris Cosby,  
3 who is in our Office of Policy and Research.

4                   So maybe, Mr. Moslander, if I could just ask  
5 you a few questions about your comments? So, I mean,  
6 and maybe a starting point for me is -- actually I  
7 changed my mind. Let me just ask Jim quick. So that  
8 your co-panelists both indicated that advice with  
9 respect to distribution should be treated as fiduciary  
10 advice. Does the ACLI agree with that?

11                  MR. SZOSTEK: If coupled with an investment  
12 advice component. We talked in our comment letter  
13 about a situation where maybe a call center gets a  
14 question, a query about needing to, for example, fix  
15 storm damage and maybe the call center discusses the  
16 possibility of taking a hardship withdrawal. That  
17 doesn't quite seem like it should fit investment  
18 advice.

19                  It's not specifically targeted to a  
20 particular investment, but I think if you were to  
21 advise someone to take a distribution for the purpose  
22 of investment monies into something else I would say  
23 that that would make a lot of sense to us.

24                  MR. HAUSER: Okay. That's as close as we  
25 get to a uniformity as I've seen, I think.

1                   So let me, Mr. Moslander, you expressed  
2                   concern in particular about the scope of the education  
3                   provisions, and I guess I'd just like to get a better  
4                   sense of what it is you think we need to alter. And  
5                   to that end, you know, I guess I'd like to just  
6                   describe what I think we've done here; that something  
7                   is not going to count as investment advice under this  
8                   proposal as currently drafted unless it's a  
9                   recommendation to somebody, you know, in the sense of  
10                  a call to action to invest in a particular investment  
11                  product, to pursue a particular investment strategy.

12                  And that can be a very contextual  
13                  determination, but the idea is are you recommending  
14                  that the person invest their money in a particular  
15                  way? That's what's covered. So descriptions of how  
16                  an annuity works, what the features are of the  
17                  annuity, what the surrender charge is, what the  
18                  circumstances under which, you know, a charge is  
19                  triggered, what the pricing is, from our perspective  
20                  all of that is education.

21                  It's not prohibited advice and it's not  
22                  problematic unless you've crossed that line and  
23                  actually recommended the specific -- you know, you've  
24                  really recommended that the person take a particular  
25                  course of action. And I just read to you from the

1 education provision, and ask, you know, assuming I can  
2 find it, and ask where you think we fall short or what  
3 you think we need to add to it.

4 So, for example, we say, you know, in  
5 connection with the fund options you can talk about  
6 the benefits of increasing plan or IRA contributions,  
7 the impact of preretirement withdrawals and retirement  
8 income, retirement income needs, varying forms of  
9 distributions, including rollovers, annuitization and  
10 other forms of lifetime income, payment options, for  
11 example, immediate annuity, deferred annuity or  
12 incremental purchase of deferred annuity, the  
13 advantages, disadvantages and risks of different forms  
14 of different distributions.

15 You can describe investment objectives and  
16 philosophies, risk and return characteristics,  
17 historical return information or related perspectives  
18 of investment alternatives under the plan or IRA. So  
19 those things are all expressly described as education  
20 in the text of this proposal, and I'm wondering what  
21 more it is you think we need to say on that score.

22 MR. MOSLANDER: I think our concern was  
23 whether it was totally clear that that applied to a  
24 description of proprietary products especially.

25 MR. HAUSER: Okay.

1                   MR. MOSLANDER: We have extensive  
2                   conversations with people about exactly how our  
3                   annuities work, what the pricing is, et cetera. We  
4                   need to make sure that that applies to a description  
5                   of proprietary products. That's our main concern  
6                   there.

7                   MR. HAUSER: Okay. I understand. And so  
8                   then in the --

9                   MR. SZOSTEK: Can I add to that?

10                  MR. HAUSER: Sure.

11                  MR. SZOSTEK: We had a comment on that as  
12                  well in your interactive materials section of the  
13                  education carve-out. It talks about not describing  
14                  specific plan distribution options, specific IRA  
15                  distribution options.

16                  So I think when you look in total, and also  
17                  when you look back to the base definition of what is  
18                  fiduciary advice, and I think, you know, as Ed said,  
19                  you know, so you had to look at the totality of this  
20                  rule. You've got an understanding that the person  
21                  when I described all of the annuity features available  
22                  under the plan was there this understanding that they  
23                  had that I was recommending the life annuity because  
24                  they kept asking me questions about well, I just want  
25                  to maximize my income.

1 I think that that's the concern is when you  
2 look at when you look at this carve-out and you look  
3 at the base definition and you look at the language  
4 about interactive materials, where's the line? Where  
5 do I cross it and maybe I need to avoid activity.

6 MR. HAUSER: Right. So, you know, I agree  
7 that with respect to the interactive materials that  
8 spit out essentially a set of recommendations to a  
9 customer that if you attach a particular product  
10 reference to that our rule would treat that as advice.

11 Similarly, if you have an asset allocation,  
12 you know, you say 40 percent in this kind of asset, 30  
13 percent in this, 20 percent in this, 10 percent in  
14 that, and then you assign a specific example to each  
15 of those things. That counts as advice.

16 But merely describing what the features are  
17 of the product, how the product works and like that  
18 really doesn't cross the line unless kind of from a  
19 contextual standpoint really you are recommending, you  
20 know, a reasonable person would think you are  
21 recommending that they purchase this product, that  
22 they take this course of action, which is the line  
23 FINRA has drawn, so why would that be a problem?

24 MR. SZOSTEK: So back to the language. It's  
25 all about the black ink on the white paper.

1                   MR. HAUSER: I know. That's what I was  
2 reading.

3                   MR. SZOSTEK: But you talk about that these  
4 are interactive materials. They don't necessarily  
5 spit out a recommendation, not the way you've  
6 described it here. It could just be information about  
7 the various different asset allocations and retirement  
8 income options, if you will, that are available under  
9 the plan.

10                   So it's not necessarily when I read this  
11 section that I'm going to get a specific  
12 recommendation that you should do this, so I  
13 respectfully disagree.

14                   MR. HAUSER: Okay. So let's suppose,  
15 although I'm hoping you can take some comfort  
16 particularly after there's a final rule in the way we  
17 interpret the words we've written.

18                   But let's suppose we, you know, add a little  
19 clarity to that point and make it clear that look, in  
20 terms of your advertising materials, your brochures  
21 merely describing the products, their features, what  
22 their terms are, inviting people to call you up and  
23 talk to you about them, that none of that is treated  
24 as advice unless you really are specifically telling  
25 them, you know, you should buy this product.

1           And assuming that, you know, we take care of  
2 whatever your textual issues are and we make clear  
3 that really for something to count as a recommendation  
4 it's got to be a call to action in the sense I've  
5 described, at that point, assuming all that, do you  
6 still think you need some carve-out that would say  
7 even if you trigger, you know, you crossed all those  
8 lines and would be treated as a fiduciary under this  
9 reg that nevertheless you should be able to treat it  
10 as a sales communication to which no best interest  
11 obligation attaches?

12           MR. SZOSTEK: Is that a question for me?

13           MR. HAUSER: Sure. I'll ask Mr. Moslander  
14 too.

15           MR. SZOSTEK: So the question, we're going  
16 from education I guess to sales exemption. You know,  
17 the broad language of this rule clearly implicates you  
18 wouldn't have had these carve-outs if it didn't  
19 implicate merely marketing, you know, or education.  
20 You wouldn't need a carve-out. The broad language  
21 implicates marketing, education, sales activities.

22           And combined, as Ed said, you know, it's the  
23 totality of this proposal, so I've got an affiliation  
24 rule that calls into question whether or not the  
25 insurance carrier itself is a fiduciary and then that

1        implicates all the revenues, every dollar or dime the  
2        insurance carrier receives or earns on any of its  
3        work.

4                    And as you know, you've got a regime that  
5        prohibits compensation unless there's an exemption  
6        granted by the Department, so sales activities. I  
7        don't think Congress intended -- it would have been  
8        easier to write a different law if Congress tended  
9        sales activities to be treated as fiduciary  
10       activities.

11                   MR. HAUSER: So let me just take, because I  
12       feel you're resisting the hypothetical a little bit.  
13       I mean, first off the carve-out may have been an  
14       unfortunate bit of nomenclature. You aren't a  
15       fiduciary unless you meet the definition of what  
16       counts as fiduciary activity, so you've got to have a  
17       recommendation to have made an investment, you know,  
18       those things at the front of the regulation, a  
19       recommendation to make an investment, a recommendation  
20       with respect to a distribution.

21                   If you don't have those kind of  
22       recommendations you need not even look at the  
23       carve-outs. You have no need of a carve-out. So  
24       maybe to the extent carve-out has suggested to  
25       somebody a negative implication that even if you don't

1 fall within that definition you're out of luck that's  
2 unfortunate and we should fix that.

3 But I guess my question still is assume, you  
4 know, I mean what I say about recommendation. It  
5 really is a call to action. Invest in this product.  
6 A reasonable person would have understood that to be  
7 the case, and you've given that, you know, and so  
8 you've crossed that line. Is there any reason why at  
9 that point you shouldn't have an obligation to adhere  
10 to a standard of prudence and best interest?

11 MR. MOSLANDER: That's exactly when we think  
12 fiduciary advice is being given is when there's a call  
13 to action, when there's a recommendation, when the  
14 advice is sufficiently individualized to form a  
15 reasonable basis for the advice recipient to believe  
16 it to be so. That's exactly when we think the  
17 fiduciary advice applies.

18 MR. HAUSER: And FINRA is more or less  
19 drawing the kind of line I'm talking about, and one of  
20 the questions we asked in the preamble was should we  
21 just essentially expressly adopt that as part of the  
22 definition. Do you have a view on that?

23 MR. MOSLANDER: We would support that.

24 MR. HAUSER: Thank you. And do you, Jim?

25 MR. SZOSTEK: Yes. Yes.

1 MR. HAUSER: Okay.

2 MS. FREESE: Mr. Hauser? Can I also make  
3 one point?

4 MR. HAUSER: Absolutely.

5 MS. FREESE: One of the concerns that we  
6 have is it shows up in the seller's exemption. It  
7 shows up in the educational component. It shows up in  
8 a number of different places. There seems to be this  
9 expectation from the industry that there's no  
10 crossover between the different types of people that  
11 you're dealing with; that someone who is a salesman is  
12 a salesman and people ought to understand that they're  
13 dealing with a salesman, and someone who is an advisor  
14 is different, and someone who is doing education is  
15 different.

16 In fact, a salesperson, to be an effective  
17 -- I've done sales, okay? To be an effective  
18 salesperson you have to establish a relationship of  
19 trust with your client or your customer. A person is  
20 not going to buy an annuity or a mutual fund or a  
21 refrigerator from you unless they trust you to a  
22 certain extent.

23 So the notion that somehow a sales activity  
24 or a presentation or any of these things can be  
25 distinguishable because there's no relationship of

1 trust once you get to the call of action, that's  
2 another thing that we're a little concerned about that  
3 we want to make sure that there's this understanding  
4 that you are developing a relationship of trust and  
5 that raises the threshold of what the people that are  
6 trusting you have an expectation about.

7 Most people expect that their advisors,  
8 whether they're salespeople or not, are acting in  
9 their best interest, and even if you tell them that  
10 they're not most of them don't have any idea what the  
11 implications of that are. And so I think it is  
12 inherent in the government to make sure that they're  
13 protected in those situations when they have a  
14 reasonable expectation that the person they're dealing  
15 with is acting in their best interest.

16 MR. HAUSER: So following up on that, do,  
17 you know, either of the other two panelists think that  
18 it should be sufficient to avoid fiduciary status  
19 after having made -- you know, when you make a  
20 recommendation if you put a disclaimer in the contract  
21 or give the person, you know, a written statement  
22 essentially saying that you should not rely upon my  
23 recommendations as a primary or other basis for your  
24 investment decision making or the like?

25 MR. SZOSTEK: I'll take that on. In 2010,

1 you included a seller's carve-out, a seller's  
2 exemption, and you had a similar question for us back  
3 in 2010-2011, the hearing, and we had followed up with  
4 some suggested language that could be used. There's  
5 some very good language. I'll compliment the  
6 Department for what is a very easy to read, well  
7 written proposal, even where we have disagreements  
8 about the terms.

9           You use the term fairly inform, and I don't  
10 think putting something in some disclaimer language in  
11 a contract that's buried in fine print is fairly  
12 informing. So I think there's a path. There needs to  
13 be a path for sales activity that it's very clear what  
14 it is that the person is doing and they make very  
15 clear to the customer that they're only going so far,  
16 that, as Ed said, it's not individualized. It's not  
17 going to serve as the primary basis for a decision and  
18 it's clear.

19           I think the other thing here is that the  
20 customer also needs to have a clear understanding of  
21 the relationship and the absence of mutuality. It's  
22 kind of like, you know, that two people can depart and  
23 they both have two different ideas about what just  
24 took place. I'm not sure that that's necessarily  
25 healthy for the market or for their protection, for us

1 to protect.

2 MR. HAUSER: But again, I'm talking about a  
3 circumstance in which you've made a recommendation,  
4 and let's assume for these purposes that we adopted  
5 essentially FINRA's approach to recommendation. So  
6 you've made that kind of recommendation.

7 Presumably because you've made that kind of  
8 recommendation with respect to, for example, a  
9 variable annuity you've had to comply with the  
10 suitability obligations at least under FINRA, which  
11 means, as described by a commenter on a later panel,  
12 it means that you're going to have collected very  
13 specific information from the customer regarding the  
14 customer's age, other investments, financial situation  
15 and needs, tax status, investment objectives,  
16 investment experience, time horizon, liquidity needs,  
17 risk tolerance and any other information the customer  
18 may disclose.

19 And you've taken that information. You've  
20 evaluated it in kind of an interactive conversation  
21 presumably with your customer and you've made a  
22 recommendation. At that point why should it matter  
23 what you put in a document or how clearly you state  
24 it?

25 I mean, if you've gone through that kind of

1 process to recommend something as complicated as a  
2 variable annuity why shouldn't the recommendation have  
3 to adhere to some fiduciary norms to be prudent and be  
4 in the customer's best interests and not be something  
5 you can disclaim away?

6 MR. SZOSTEK: And I wouldn't argue that we  
7 should be able to disclaim it away. I think the  
8 implications, as I said, of the entire proposal are  
9 such that an insurance carrier would become a  
10 fiduciary and now again how do you operate as a  
11 fiduciary under ERISA given the prohibitions on  
12 compensation? It's just an ill-fitting suit.

13 We manufacture investment products for our  
14 customers. It's the sales activities. Our sales  
15 activities, to the extent that the Department views  
16 them as fiduciary activity, they need to have a path  
17 for the insurance carrier to operate as they've been  
18 operating under state insurance law and generate the  
19 revenues they need to make good on the commitments  
20 that they're promising.

21 MR. HAUSER: All right. Mr. Moslander, was  
22 there anything you wanted to say?

23 MR. MOSLANDER: We believe that when you  
24 make a recommendation you've taken fiduciary  
25 responsibility. That's how we deliver advice today,

1 and we take fiduciary responsibility for the advice  
2 that we deliver.

3 MR. HAUSER: Thank you. So maybe continuing  
4 along this line, so we do intend for the best interest  
5 contract exemption in particular to enable you to sell  
6 a proprietary product. We have a section on the sale  
7 of proprietary products in that exemption, and it's  
8 our view obviously that that -- or we wouldn't have  
9 included in the exemption that you can both make  
10 recommendations from a menu that's limited to  
11 proprietary products and comply with ERISA's, you  
12 know, fiduciary obligations.

13 And what else is it you think we need to say  
14 on that score to be clearer about the pathway for you  
15 to go ahead and give investment recommendations that  
16 comport with the fiduciary, you know, standard when  
17 you're limited to proprietary products? Anybody?

18 MR. MOSLANDER: Well, if the education  
19 carve-out works as you described it we probably don't  
20 have as much issue with the BIC exemption. Our issue  
21 is the educational carve-out and the breadth of it and  
22 then perhaps the timing and sequencing of when the BIC  
23 exemption takes place.

24 As I said, as we all said, these annuity  
25 products are complicated. It takes multiple

1 interactions and somebody may or may not do something  
2 based on all those interactions and so it becomes  
3 really the timing and sequencing of when, you know,  
4 the BIC exemption applies and when advice is being  
5 given. If we moved it up to the advice is being given  
6 when a recommendation is made that would make things  
7 certainly more palatable.

8 MR. SZOSTEK: And on the best interest  
9 contract exemption, so the proprietary carve-out  
10 requires that the insurer have some finding that  
11 they've got reasons to do proprietary sales, and it's  
12 also got its own definition of reasonable  
13 compensation, which is different than other  
14 definitions within the best interest contract  
15 exemption and 84-24.

16 Again, it's a different bar. It's a higher  
17 bar for the proprietary sale. On an exemption that  
18 has been described by many as unworkable, it's how do  
19 I know my compensation is reasonable? Do I have to  
20 wait for Judge --

21 MR. HAUSER: Yeah. Well, people --

22 MR. SZOSTEK: -- to hit the gavel and say --

23 MR. HAUSER: Yeah.

24 MR. SZOSTEK: -- your compensation is  
25 reasonable?

1                   MR. HAUSER: I mean, people were describing  
2 it as unworkable before they even saw the text.

3                   MR. SZOSTEK: There may be those who did  
4 that.

5                   MR. HAUSER: Yeah. So, I mean, again, you  
6 know, it's not our intention to keep folks from making  
7 recommendations with respect to proprietary products.

8                   I think you mentioned that you would prefer  
9 that we not have used the without regard language and  
10 that instead maybe we use the language just right from  
11 the statute, the loyalty language that people have  
12 been using, you know, the exclusive purpose language.

13                   And so maybe but if we did that and if we  
14 defined what the fiduciary obligation means and the  
15 proprietary context and, you know, in particular what  
16 if we said that, you know, you've done your job if  
17 this is a product that can prudently be recommended if  
18 the fees are reasonable in relationship to the product  
19 and the services both that are being provided under  
20 it, if your salesperson, your agent, your advisor,  
21 whatever, your rep, whatever you choose to call them,  
22 is not incentivized --

23                   Well, first off that he or she is not making  
24 recommendations based on their own financial interest,  
25 but rather what's in the interest of the customer and

1 that you haven't created financial incentives or that  
2 you've reasonable designed policies and procedures to  
3 make sure that that salesperson is giving advice  
4 that's prudent and meets the best interest standard  
5 and it doesn't incentivize a person to act contrary.

6 I mean, if we gave that kind of guidance and  
7 said as long as you meet something along those lines  
8 you can go ahead and make recommendations limited to a  
9 proprietary product, and, you know, we have language  
10 in there already. You'll tell the person this is all  
11 I do. You're coming to me. You're only going to look  
12 at these proprietary things. Would that go a long way  
13 to solving the problem, or do you think you still have  
14 a problem potentially?

15 MR. MOSLANDER: I would say clarity would go  
16 a long way. I think the comments that we've made  
17 around the totality of the proposal and the  
18 uncertainty that that brings to us is the concern.

19 So to the extent that we can clarify, you  
20 know, through the language how to ensure our ability  
21 to sell propriety products, I think we'd get much more  
22 comfortable. But for us it's really around the  
23 clarity. It's an uncertainty, and that's difficult to  
24 deal with.

25 MR. HAUSER: Okay.

1           MR. SZOSTEK: I think an example of clarity,  
2           so the definition of reasonable compensation in 84-24  
3           is in our opinion clearer than the definition that's  
4           in the best interest contract exemption.

5           The trouble, and to Ed's point exactly, it's  
6           about certainty. Up until this exemption, exemptions  
7           have typically been if then, if you do this then you  
8           have an exemption. This one is a maybe, and maybes  
9           don't work. You need to know is this compensation  
10          permissible or is it not permissible and then we can  
11          move on.

12          And again, as I said, to implicate the  
13          insurance carrier and now you're implicating its  
14          revenues and its profits, it's kind of how do you  
15          determine reasonable compensation. On annuities you  
16          don't know up until, you know, the contract terminates  
17          in many cases whether or not that particular contract  
18          was profitable or not profitable.

19          So we hear a lot of talk about the agents.  
20          You know, it's all about the agents acting in the best  
21          interest. We agree. Agents should act in the best  
22          interests of the customer, but you're bringing in more  
23          than just the agent here.

24          MR. HAUSER: Well, yeah, but so let's say, I  
25          mean, just taking your issue. I mean, suppose we said

1 that reasonable comp is just reasonable compensation  
2 in the 408(b)(2) sense, which is what you're already  
3 living with.

4 MR. SZOSTEK: Uh-huh.

5 MR. HAUSER: And again, we rely on these  
6 standard ERISA obligations of prudence and loyalty,  
7 and we make it clear that you can, you know, do that,  
8 you know, in a proprietary capacity the same way. I  
9 mean, you use 84-24 now in a propriety capacity, so it  
10 can't be that it's intrinsically inconsistent with  
11 being a fiduciary that you're selling a propriety  
12 product, right?

13 MR. SZOSTEK: Well, the current five part  
14 test doesn't include the affiliation.

15 MR. HAUSER: I see. And can you explain to  
16 me what your concern is about the affiliation piece?

17 MR. SZOSTEK: Well, in propriety sales  
18 you're implicating again the insurance carrier and its  
19 revenues, every dollar it makes as possibly conflicted  
20 revenue. You know, maybe it's conflicted, but the  
21 point is they need to earn revenue, and then the  
22 question is what is reasonable revenue.

23 Again, especially for lifetime income  
24 products you won't know what your revenue is until  
25 that annuity stream is ended and you see whether or

1 not that particular contract was profitable.

2 MR. HAUSER: Well, I don't think that's why  
3 reasonable comp works. It's reasonable comp based on  
4 the deal at the time you make it, and this is a  
5 standard you necessarily live under right now.

6 MR. SZOSTEK: Yeah. Well, and the  
7 expectation -- it's a reasonable comp standard under  
8 408 for service arrangements. I think it's a big  
9 apples and oranges, and we can follow up with  
10 additional comment on this.

11 MR. HAUSER: Okay. So let me ask just in  
12 terms of the concern about you're kind of in or out of  
13 the exemption. I mean, obviously one way to deal with  
14 that, which we've done to some extent with respect to  
15 these warranties, for example, the warranty that  
16 you're not incentivizing your people to act contrary  
17 to the customer's interest.

18 You've satisfied the exemption if you've  
19 made the warranty. If you don't comply with the  
20 warranty that may expose you to a claim from your  
21 customer, which is going to be an arbitration, an  
22 individual case, or it's going to be a class action  
23 potentially if it's a systemic sort of violation.

24 But if you made the warranty and you  
25 otherwise complied with the contract conditions you

1 haven't violated the exemption because the exemption  
2 is conditioned on the issuance of the warranty, not on  
3 compliance with that warranty. So I think to the  
4 extent some of your concerns, you know, on operability  
5 are based on an assumption that violation of the  
6 warranty necessarily blows the exemption that's  
7 mistaken.

8           And so the question I have is just when  
9 you're thinking maybe about comments to give us you  
10 might think about to the extent you need certainty to  
11 some degree the contract lends itself to that sort of  
12 thing. You execute a contract that contains the  
13 relevant promises to your customer and we leave the  
14 enforcement perhaps of whether or not there's a  
15 violation or not to the customer, but we don't say you  
16 blew the exemption. And, you can, you know, include  
17 more or less of the conditions of the exemption in a  
18 contract that way, so just something to think about in  
19 connection with this.

20           And then last question and then my long  
21 suffering colleagues. Joe is nodding his head.

22           MR. CANARY: Well, we only have three  
23 minutes left, so --

24           MR. HAUSER: Ten minutes.

25           MR. CANARY: But they're excellent questions

1 you're asking.

2 MR. HAUSER: They are. That stuff doesn't  
3 actually work with me.

4 (Laughter).

5 MR. CANARY: But I'll keep trying.

6 MR. HAUSER: But at the start, and I want to  
7 return to this, Jim. You said that it was important  
8 that there be an alignment of the interests of the  
9 customer, which I think in a lot of cases you think  
10 the annuity purchase promotes with the interest of the  
11 advisor.

12 With that in mind and assuming that this is  
13 a contractual warranty, breach of which wouldn't put  
14 you out of the exemption; it would just expose you  
15 potentially to a claim from your customer, is there  
16 something that makes it unworkable for insurance  
17 companies and for people who make insurance product  
18 recommendations to do it in such a way that the sales  
19 force, the reps, aren't incentivized to move products  
20 in a way that departs from what's in the interest of  
21 the customer?

22 MR. SZOSTEK: Is there a way for you to  
23 write an exemption to do that?

24 MR. HAUSER: No. I'm asking. We wrote  
25 that. The question is if our ask, you know, is that

1 you execute a contract that gives a warranty to  
2 somebody that says look, we're not incentivizing this  
3 person you're dealing with that's having all these  
4 conversations with you about how to invest their  
5 money. We do not incentivize people to act in a way  
6 that departs from your best interest. Is that  
7 something that makes this unworkable from the  
8 insurance industry's perspective, because I worry  
9 about that.

10 MR. SZOSTEK: Oh, I don't believe that. Let  
11 me just say it. There are issues with some of the  
12 language in the warranty section, but we didn't take  
13 issue with the warranty section.

14 MR. HAUSER: Okay. And, Mr. Moslander?

15 MR. MOSLANDER: We think the contract  
16 handles it. I'm not sure that the warranties aren't  
17 redundant or they seem sort of redundant. The  
18 contract seems to handle what it is. It provides  
19 necessary remedies.

20 MR. HAUSER: Right. And, I mean, would you  
21 think that implicit in the best interest obligation is  
22 an obligation to have those kind of policies and  
23 procedures to prevent people from acting contrary to  
24 the best interest standard?

25 MR. MOSLANDER: Yeah.

1 MR. HAUSER: Yeah? Please.

2 MR. CANARY: Okay. Thank you. I'm not sure  
3 it's probably worth spending a lot of time on this  
4 because I think the conversation you've had with Tim  
5 has really tried to explore the question I'm about to  
6 ask, but we've had a fair amount of commentary with  
7 three different things.

8 People have suggested we expand the  
9 education provisions to allow specific investment  
10 alternatives to be included in asset allocation,  
11 they've suggested that we expand the seller's  
12 exception to cover the retail market participants,  
13 beneficiaries and IRA owners, and they've suggested  
14 that there be a mutuality requirement in the general  
15 definition of fiduciary for a person making a  
16 recommendation be treated as an investment advice  
17 fiduciary.

18 Do you see a concern when you take those  
19 three things together where they are a lot discussed  
20 in isolation, you put them together, that we are  
21 running the risk of re-establishing something akin to  
22 the five part test that we currently have?

23 You'll end up with a person being able to  
24 make aggressive recommendations in a sales position as  
25 long as they are clear it's sales. They'll be able to

1 say I'm not intending to provide investment advice and  
2 say they're avoiding fiduciary status under the  
3 general definition and they'll be able to have  
4 education, which puts in specific investment  
5 alternatives as long as they say well, there's other  
6 options out there for you. I guess that's the same  
7 question for all three.

8 MS. FREESE: Well, you know, I guess I can  
9 start by saying yes, and not only I think the Pension  
10 Rights Center would be concerned about the confluence  
11 of those three pieces. If you don't handle the  
12 individual items on that list carefully you risk  
13 undermining the entire rule by any one of those  
14 components.

15 For example, the mutuality, which I  
16 mentioned also in my testimony. If you're not  
17 careful, we believe that the language that you already  
18 have in there lends itself to the possibility of being  
19 interpreted to allow a disclaimer, which puts us  
20 exactly back where we are right now.

21 The educational component, once you start  
22 populating with individual products you have to be  
23 very, very careful how that is done so that you don't  
24 end up creating a situation where people perceive that  
25 this is a recommendation because again, you are in an

1 environment where by definition you've already created  
2 an environment of trust with these people because  
3 otherwise they wouldn't buy from you.

4 So not only is the confluence of all three  
5 items a possibility of creating a five part test; if  
6 you're not careful about every one of those individual  
7 components you could undermine the totality of the  
8 rule by what you're trying to do.

9 MR. CANARY: Mr. Moslander?

10 MR. MOSLANDER: I guess it's possible. It's  
11 certainly possible. I would agree that you have to be  
12 careful on how you construct it. We're not  
13 necessarily saying there has to be the mutuality, but  
14 we do believe that recommendation has to be  
15 individualized enough to be fiduciary level advice.

16 So these are fine lines, no doubt about it.  
17 Certainly that risk could be there, but I don't think  
18 it has to be. I think we can clarify how they work  
19 well enough so that we're not in the same place.  
20 We're in, you know, a somewhat better place.

21 MR. SZOSTEK: And, Joe, the education piece,  
22 I think it's important to think about how that can  
23 operate. So you could have a variable annuity with 20  
24 investment funds, and so to give them an asset  
25 allocation that didn't specify the funds that are in

1 the contract, the international fund was the only  
2 international fund, sort of like a 401(k) plan with  
3 designated investment alternatives of 10. You know, a  
4 fiduciary picked them.

5 Educating about investments, educating about  
6 distribution options I think I would encourage the  
7 Department to think carefully about how that would  
8 work in sort of day-to-day, practical basis, but I  
9 understand your point about steering people into  
10 something that would not necessarily be in their best  
11 interest and, you know, the lack of a mutual  
12 understanding or there is mutuality or whatever,  
13 whatever the case may be.

14 You could go down the wrong path as far as  
15 the Department is concerned. I would encourage the  
16 Department to think about how these products and these  
17 services are offered on a daily basis and not  
18 necessarily steering anyone into anything. They're  
19 just trying to make things -- you know, helpful  
20 information for the customer.

21 MR. CANARY: Thank you. Two much more  
22 specific questions mainly I think for the ACLI, but  
23 anyone who has thoughts is obviously welcome.

24 So currently under the general definition of  
25 fiduciary if you're outside of the investment advice

1 component and then the other fiduciary provisions  
2 there isn't a mutuality requirement. Your status as a  
3 fiduciary is more of a functional test, not dependent  
4 upon the intent of the person who is engaged in  
5 conduct that may make them a fiduciary.

6 What is it about the investment advice  
7 provision where that kind of a requirement should  
8 exist where it doesn't exist in the other provisions  
9 of the fiduciary definition?

10 MR. SZOSTEK: I think it goes back to the  
11 Halloween 75 reg, right, and it goes back to this was  
12 written closely after the enactment of the law. I  
13 think they had a good sense of what Congress was  
14 intending and how do you differentiate it. It's a  
15 struggle that we've been playing out this week is how  
16 do you differentiate between sales activities,  
17 marketing activities and trusted fiduciary advice.

18 Clearly if there's a contract, if there's an  
19 agreement obviously there is mutuality. How can you  
20 have an agreement if there's no mutuality? I think  
21 the understanding is kind of the key word in that  
22 phrase that, you know, are we on the same page, and I  
23 think that's important.

24 MR. CANARY: And maybe we can have further  
25 dialogue because I think what we tried to do in the

1 proposal was focus on conduct that would reflect sort  
2 of a reasonable basis to conclude that there was a  
3 relationship of trust without putting the status of  
4 fiduciary in the control of the person making the  
5 recommendation where they could say but I'm not  
6 agreeing to provide investment advice.

7 So maybe that's another area where care in  
8 defining it could provide a level of certainty you're  
9 looking for, but not run into the sorts of concerns  
10 that the Pension Rights Center has identified.

11 MR. SZOSTEK: I think certainty is  
12 important. I can't imagine the PRC would object. I  
13 think people need to know what the relationship is.  
14 This is going to be a trusted fiduciary advice  
15 relationship. I want to know that now. I don't want  
16 to, you know, have some sort of --

17 You know, the language includes the word  
18 indirect. Indirect was in the law about fees, but  
19 indirect advice. I don't know what indirect advice  
20 is. So did I get indirect advice?

21 MR. CANARY: Okay.

22 MR. SZOSTEK: There's a lot of ambiguity  
23 that just doesn't give the certainty that I think the  
24 public deserves and the financial services industry  
25 needs.

1 MR. CANARY: All right. I think we probably  
2 could use a little less ambiguity than maybe some of  
3 the commentators, but next issue -- much more  
4 tactical, which is I think we've been clear at various  
5 points in this hearing and otherwise that this rule  
6 doesn't extend to group health plan and disability  
7 insurance recommendations.

8 I think your testimony incorporated life  
9 insurance, and I think we have reserved that to say  
10 well, life insurance may have investment components  
11 where it seems like that sort of a recommendation fits  
12 into the rule and the purposes of the rule. So can  
13 you talk a little bit -- I know we just ran out of  
14 time -- about why you think life insurance should also  
15 be excluded from the scope of the rule?

16 MR. SZOSTEK: All right. Joe, I think I  
17 have a minute.

18 MR. CANARY: Excellent.

19 MR. SZOSTEK: So let me give it a go. So a  
20 couple things. One is when you think about welfare  
21 benefit generally I think it's fair to say that the  
22 sale of the product to the employer, to the plan,  
23 shouldn't be considered investment advice.

24 Now, there may be a life insurance policy  
25 that has investment components in it, but in general

1 we don't see the analysis I think that would be  
2 necessary to understand the products, the features,  
3 the way the plans operate in this proposal, and we  
4 would encourage the Department at the very least to  
5 reserve any action with respect to welfare benefit  
6 plans for further rulemaking.

7 MR. CANARY: Thank you.

8 MR. HAUSER: Thank you.

9 (Pause.)

10 MR. HAUSER: Okay. It's not break time.  
11 So, Mr. Callahan, whenever you're ready.

12 MR. CALLAHAN: Good morning. Thank you for  
13 the opportunity to be here today. My name is Caleb  
14 Callahan. I'm the Senior Vice President and Chief  
15 Marketing Officer for ValMark Securities, and I'm  
16 testifying today on behalf of the Association for  
17 Advanced Life Underwriting, and I'm really grateful to  
18 be here to testify on behalf of our members, 2,200  
19 members across the country, primarily life insurance  
20 professionals who serve clients with estate planning,  
21 charitable planning, business planning, financial  
22 planning needs.

23 Our firm, ValMark, is a member of the AALU.

24 We're located in Akron, Ohio. We've been in business  
25 since 1963, and we're an interesting blend of broker

1 dealer, as well as a registered investment advisor.  
2 We have about \$14 billion of assets under care, and  
3 that is split evenly between the fiduciary fee-based  
4 regime, as well as the commission broker dealer  
5 regime.

6 And I only share that just so you know I  
7 have context. As we build plans, we do a lot of  
8 written financial plans, and an ability to offer  
9 solutions from both of those buckets, we find that  
10 they are used relatively regularly, both of them, that  
11 they are necessary. In fact, about 55 to 60 percent  
12 this year we're projecting will be the RIA fee and  
13 about 40 to 45 percent will be the broker dealer.

14 My goal today is not to criticize. I'm  
15 really here to offer constructive feedback based on  
16 real world experience as to how this will impact  
17 savers and to also talk about the practical  
18 implications of the rule. While well intended, I  
19 really do believe there will be adverse consequences.

20 And finally, I'm here to speak on behalf of the  
21 clients we serve to preserve their right to make  
22 choices that are in their best interest, but as they  
23 determine that best interest to be.

24 Kind of three buckets of information I want  
25 to cover quickly. One, I see a really big opportunity

1 to build on the existing regulatory framework; two,  
2 some of the conflicting messages that this rule as  
3 proposed sends; and finally, what are the implications  
4 of those things on consumers.

5 Just briefly, on the opportunity I see  
6 before us, you know, the SEC, I've read a number of  
7 the comment letters. I've read the letters from  
8 members of Congress, policymakers on the Hill that  
9 they've sent to the Department about how the SEC  
10 currently has a fiduciary standard and oversees many  
11 of the individual retirement accounts and that perhaps  
12 they're best to take the lead on this standard.

13 I know people have talked about FINRA and I  
14 heard that mentioned a number of times on the previous  
15 panel, and their own comment letter talking about this  
16 isn't business model neutral and that this fracturing  
17 of a new fiduciary standard that is ERISA, under  
18 ERISA, and a fiduciary standard under the SEC both  
19 overlapping, how will that actually work?

20 You've read those comment letters. I'm not  
21 going to spend time on the opportunity there to have  
22 them take the lead. To me it's more about how can the  
23 Department build on its own framework. And the  
24 Department has done an incredible job. I look, I  
25 heard 408(b)(2) mentioned earlier, and in 2012 you

1 finalized those disclosure rules and they did three  
2 things in their attempts to provide clarity in the  
3 market. They disclose the services provided to the  
4 customer, whether the capacity was a fiduciary or not,  
5 and the cost and fees associated with those services.

6 And I just would pause and ask has the  
7 Department had an opportunity to analyze the impact  
8 that those rules have had and if the impact that  
9 they've had is towards the outcome that you want, and  
10 if not is there an opportunity to perhaps amend those.

11 You know, as someone who is in favor of smart and  
12 well-informed regulation, I would say our business  
13 data shows that that is working.

14 Since 2012, we've had two full years.  
15 Broker sold or commission-based plans have grown at a  
16 rate of 26 percent over that time, whereas fee-based  
17 fiduciary plans have grown at a rate almost five times  
18 that at 114 percent. If I dig into the retirement  
19 qualified plan specialist practitioners, the broker  
20 sold plans have declined by 85 percent, whereas the  
21 fiduciary sold plans grew by 21 percent.

22 The reason I share that is just to say that  
23 the rules that you put in place seem to be working if  
24 the goal is to create in practice more people when  
25 given the choice choose a fiduciary standard, and yet

1 those rules preserve the ability for people to choose  
2 to operate in a brokerage capacity if that is what  
3 they want while the smaller plans are actually more  
4 cost efficient. So that's the first category of  
5 information.

6 The second is beyond just an opportunity to  
7 build on your existing work, I would say the rule as  
8 proposed does create some conflicting messages, and I  
9 would start with the GAO study in 2011 on retirement  
10 income. The Department worked closely with the GAO,  
11 as well as the Treasury Department, and the study had  
12 a number of things, but two themes that really jumped  
13 out were the importance for consumers to do analysis  
14 on working longer and delaying social security, as  
15 well as the role of income annuities in their plan.

16 And I would just say on the first one, and I  
17 heard the comments about education that there is a bit  
18 of conflict and restriction on when you go to give  
19 someone advice about social security it's not going to  
20 happen in a vacuum. It's going to be in concert with  
21 what are your income goals? What other resources do  
22 you have? How are these going to fit together?

23 It's not hypothetical. It's not general.  
24 It's very specific. And I just wonder, the rule as  
25 proposed, if you're going to be able -- we're going to

1 be able -- to take action that the GAO recommended as  
2 one of the main solutions in the market.

3 The other thing I would say is the  
4 importance of annuities. I'll just give you a couple  
5 excerpts from that report. The research concluded  
6 that annuities offer important benefits. Some  
7 academic and consumer groups went as far as to say  
8 they should be required in the use of retirement  
9 plans. They reported that it is the middle quintile  
10 of households that have the most need for these  
11 because the wealthier households have the assets to  
12 withstand a financial storm.

13 And again, I would point back to when this  
14 report was written that was on the heels of the  
15 retirement or, I'm sorry, the financial crisis, and  
16 sometimes we have short memories what it's like when  
17 you see 40 or 50 percent of an account balance go away  
18 and we think boy, should we really be making it harder  
19 to access solutions that could help in that space?

20 The Treasury took this report very  
21 seriously. Last year they issued qualified longevity  
22 annuity contract regulations, final T regs, on using  
23 annuities inside of plans. Those products are just  
24 now available in the marketplace, and unfortunately  
25 the rule as proposed I think it's reasonable to

1 interpret it would prohibit the use of the very  
2 solutions that were just proposed last year and the  
3 products being made available this year.

4           And then finally I would say on this idea of  
5 conflicting messaging, the SEC has a fiduciary  
6 standard, and operating in both regimes the broker  
7 dealer and the SEC regime, the SEC has come in and  
8 said there are times where the best interest or the  
9 fiduciary standard is not the best recommendation,  
10 kind of myth busting this idea that the fee regime is  
11 always the best regime.

12           They've come in with reverse churning and  
13 say if you have holdings where you're giving someone  
14 advice and building a plan and a part of that  
15 portfolio, maybe it's low basis or they have a  
16 long-term need for that asset, you should not put that  
17 in a fee-based account. You should put that in a  
18 brokerage account. And so they're testing and  
19 examining, and this rule will do the opposite and so  
20 you wonder when IRAs are overseen by two competing  
21 fiduciary standards which would I do in that scenario.

22           And then finally, the practical implications  
23 to consumers, and the first, and you've heard this,  
24 the loss of access. And the GAO study talks about the  
25 importance of managing longevity risk, market sequence

1 of return risk. AARP said 57 percent of Americans  
2 have saved less than \$25,000, and that's the area  
3 where those risks are most important to manage. They  
4 don't have the buffer to withstand the impact on those  
5 accounts, and this rule, as kind of a de facto  
6 measure, would eliminate much of the opportunity they  
7 have to transfer those risks to third parties.

8 And then I would also say not only do you  
9 eliminate the ability to transfer those risks to third  
10 parties, that access in general is limited as a result  
11 of this. And I know you've read the comment letters.

12 People have talked about the United Kingdom, and I'll  
13 admit I'm not an expert on the United Kingdom, but I  
14 did note that 10 days ago the Economic Secretary of  
15 the Treasury launched an examination into the advice  
16 gap that exists in the country or if there is an  
17 advice gap and what it is only two years after their  
18 rule.

19 Again, I'm not an expert, but I would just  
20 say that action I would hope would give great pause to  
21 the Department to at least see what exactly their  
22 findings are. The other example I think is people use  
23 these as straw man arguments. They think well, you're  
24 just saying that because, you know, it's a good sound  
25 bite. And I would say these are very real things.

1 This is not a statistic. This is not a metric.

2 And I was reminded of this. Last week I got  
3 a call from my mom and dad. They're 64 years old.  
4 Actually my mother called me, and she had a series of  
5 questions about Caleb, we have \$25,000. They do a lot  
6 of volunteer work. They have not made much money.  
7 They're wonderful people. Financial accumulation is  
8 not something they've done a great job of. And they  
9 asked a series of questions. Should we file social  
10 security? Should we file and suspend? Which money  
11 should we take and use? Can we trust the banks? All  
12 these things.

13 And I was able to sit down and walk them  
14 through that, but if I weren't their son and somebody  
15 was going to need to be a fiduciary to them to do that  
16 and to give them answers to those questions, 1 percent  
17 of \$25,000 is \$250. As a practitioner I would tell  
18 you there are few, if any, who would come in with this  
19 kind of unlimited liability as a fiduciary and take  
20 the risk and uncertainty of answering these questions  
21 and easily just pass on is my opinion of what will  
22 happen.

23 And finally, I'd like to conclude with the  
24 impact on consumers not only being lost access, but  
25 lost choice. I think consumers should have the right

1 to make choices, and if they are uninformed in a  
2 particular area or unaware then let's roll up our  
3 sleeves and get serious about how we can help bridge  
4 that gap.

5 Other markets have shown that this can be  
6 done. Standardized disclosures, good faith estimates,  
7 data conformity templates. It's not about regulatory  
8 regimes that gives us remedies after the fact to go  
9 back and unwind transactions in the most effective  
10 manner, but how about up front helping them have the  
11 data on one page that can help make a better decision?

12 May I take just one more minute?

13 MR. HAUSER: Sure.

14 MR. CALLAHAN: And the idea of preserving  
15 choice, it's personal. It's unique. It's not  
16 general. And the lowest price, the cheapest, is not  
17 always best. And those of us who have the opportunity  
18 to own a home, you were offered the opportunity to buy  
19 a home warranty, for example. There was no scenario  
20 when buying that warranty was cheaper in the short  
21 run, but whether it's cheaper in the long run depends  
22 on what happens. It depends on the future. And if we  
23 could predict the future we wouldn't need it.

24 But to not allow them a workable way to have  
25 access to these solutions, I don't believe that that

1 can be in their best interest. And so in short I  
2 would say that we have to allow savers the ability to  
3 choose to do things that are in their best interest,  
4 but as they determine that interest to be, not  
5 necessarily regulators.

6 And so in conclusion I would say I agree  
7 with the goal of the Department in protecting  
8 consumers. If we're serious about this problem we  
9 can't jump to conclusions and experiment with a  
10 solution without quantifying why it's necessary nor  
11 examining how we can build upon the existing  
12 regulatory framework that's in place.

13 And the new rule cannot send contradictory  
14 messages from other government initiatives nor create  
15 adverse consequences for consumers with loss of access  
16 and loss of choice, so for these very reasons the AALU  
17 supports building on existing framework and focusing  
18 on simple, one-page disclosures modeled after your own  
19 408(b)(2) regs with cost, roles, conflicts.

20 And I would volunteer personally to be a  
21 resource in helping craft those type of benefits for  
22 consumers, and so with that I'd just like to say thank  
23 you for the opportunity to share with you for a few  
24 moments this morning.

25 MR. HAUSER: Okay.

1 MR. WIMPEE: Thank you guys. I just want to  
2 thank you for the opportunity to speak with you today.

3 My name is Joe Wimpee. I'm the owner and the  
4 president of the Joe Wimpee agency in Rockwell, Texas.

5 I may be the only guy here that hasn't been some CEO  
6 of some company or something else. I don't know, but  
7 we'll find that out at the end of the fourth day, I  
8 guess. We appreciate the opportunity just to kind of  
9 give you our opinions on the suggested conflict of  
10 interest rules too.

11 Farmers Financial Solutions, which I'll  
12 refer to as FFS, is a, was formed in 2000, and it's a  
13 registered broker dealer owned by Farmer Insurance  
14 Exchanges. FFS works with middle class customers that  
15 rely on their Farmers agents as trusted advisors. We  
16 have selling agreements with a variety of well known  
17 mutual fund families like American Funds, BlackRock,  
18 Franklin Templeton, Voya, Principal, Oppenheimer and  
19 more.

20 Of the close to 14,000 exclusive agents that  
21 we have for Farmers, just about 5,400 of them are  
22 registered reps of FFS. Collectively we open about  
23 24,000 customer accounts per year, which result in  
24 approximately \$600 million in investable assets using  
25 FFS on an annual basis.

1           At the outset I'll tell you Farmers agents  
2 work in the best interests of our clients. We work in  
3 the best interests of our clients, and hopefully I can  
4 provide some information that will validate that.  
5 We'll discuss with you concerns with the proposal as  
6 written, but establishing a standard that asks us to  
7 work in the best interest? That's not a problem for  
8 us, okay?

9           I'd like to spend my time here just real  
10 quickly to tell you about my business, my customers  
11 and how I serve the role as a trusted advisor to them.

12        I have brought with you my written testimony, which  
13 you guys will have, that gives our recommendations.  
14 We have a proposal for you. We also submitted  
15 comments back in July. We will submit additional  
16 comments after this meeting to follow up.

17           I feel it's very important that you  
18 understand the advisors' perspective so that you  
19 better understand the impact of your proposal, so I'm  
20 going to tell you a few stories about just clients,  
21 and this is stuff in the last 60 days, that occur in  
22 my agency so you kind of get an idea of where we come  
23 from.

24           I've got a small restaurant group. It has  
25 about 35 employees. We started a 401(k) plan. So we

1 get them started. They've never invested before.  
2 They never had a 401(k). They're restaurant workers,  
3 so they're waiters, they're cooks, they're busboys.  
4 So they're not the most sophisticated financial people  
5 in the world making great financial decisions  
6 typically, okay?

7           And so we set it up. It's a good plan.  
8 It's got a perfect way to online enroll. We go  
9 through education meetings. I go out and meet with  
10 each group of them and go through education, tell them  
11 how to enroll, what they need to look at, what their  
12 questions should be, answer their questions about what  
13 is this, Joe? How does this work? We go through  
14 that. We do a lot of due diligence helping them.

15           We come back six months later. All of a  
16 sudden none of them are enrolled. Three people  
17 enrolled, all managers. Huh. That's kind of what we  
18 thought, right? Why aren't they enrolled? They're  
19 not enrolled because they asked a question in the  
20 meeting. How many of you guys have enough money to  
21 retire? None of them. How many of you guys know you  
22 need to save? All of them raise their hands. So why  
23 aren't all of them acting?

24           They're not acting because of fear -- fear  
25 of picking the wrong fund, fear of making the wrong

1 button pushed on the machine, fear of not  
2 understanding the complexities of the process. So I  
3 go back out to the manager, set up little meetings  
4 with five people at a time. I'll bring paper  
5 applications out and let's see what happens.

6 We go back out. All of them start signing  
7 up instantly. \$25 a month, \$50 a month. I'm a  
8 commission based guy. On that account I think I make  
9 .30 basis points on everything that comes in. No up  
10 fronts, just .30 basis points on trails. So you can  
11 do the math what I make, 10 bucks a month if all of  
12 them are signed up. Not much money. Not much money.

13 How can I do that? Because I have a base of  
14 insurance business that compensates and builds my  
15 bricks and mortar that allows me to meet with  
16 customers unbiased, without emotion, that allows me to  
17 be a true fiduciary acting in their best interest at  
18 all times.

19 I'll tell you another story. Another lady  
20 comes in. Her and her husband come in to review their  
21 auto and home. We try to do it annually, every two  
22 years, to make sure they don't have any gaps in their  
23 coverage. Their auto is right, their home is right,  
24 their life insurance needs are right, whatever it may  
25 be.

1           In the process of those reviews I always ask  
2 the question: Hey, do you have any investments you'd  
3 like for us to look at or study? And sometimes it  
4 comes up. Sometimes it doesn't. This time this guy  
5 is a do-it-yourselfer. He's a Vanguard guy, an online  
6 guy, a day trader, and he's done this for most of his  
7 life. He's 64 years old, 62 years old. And so he's  
8 doing this and he's happy with it. He takes my  
9 advice, but he just kind of stays back, so just  
10 talking to him.

11           Well, a few years later than that I get a  
12 phone call from the wife. Her husband had passed  
13 away, and he had told her just go see Joe when you die  
14 -- when I die. Just go see Joe. So she brings in  
15 three boxes of papers, not knowing what any of it is -  
16 - statements, account balances, all kinds of stuff --  
17 and she's trying to be strong and she's having the  
18 conversation. Joe, I think this is this and this is  
19 this.

20           And I can just see she's just nervous and  
21 scared to death. Her hand is on the table. I reach  
22 over and put my hand on top of hers and say it's going  
23 to be okay. This is what we do. This is what we do.  
24 We will help you through this. You'll be fine. Your  
25 husband has done a great job of getting you here. We

1 will help you get past this, and you will be fine.

2 Roll the clock forward 10 years. She's been  
3 with me 10 years. She's been drawing money out of  
4 this account, A share mutual funds, been drawing money  
5 out of these accounts for the whole time through the  
6 downturn in 2008, nothing wrong. We haven't made  
7 changes. We just keep moving forward, and she's lived  
8 wonderfully and been able to help her kids and her  
9 grandkids through her processes. It works. The  
10 advice and the work we do works.

11 I don't want to change what we're doing  
12 currently and have to be a fee-based guy necessarily  
13 so I have to charge her more money. I don't want to  
14 charge her more money, and a fee-based scenario with  
15 her would be more money in the end game 10 years in  
16 than it is the way we're currently doing it.

17 I'll give you a high net worth guy example.  
18 I've got a guy that he makes about a million bucks a  
19 year for a big CPA firm in Dallas. He's a  
20 do-it-yourself guy. He's been a client of mine --  
21 auto/home -- forever, and he thinks, Joe, I'm not  
22 going to invest with you. You're a stupid insurance  
23 guy. Why do I want to do that? That's his term. We  
24 laugh. We have fun with it. He's a buddy of mine,  
25 okay, but that's the way they look at me sometimes.

1                   And so for years I just would send him a  
2 piece of information. Here's a little advice. Here's  
3 a little advice, just send it to him in the mail, just  
4 some kind of information, some study, some something.

5           All of a sudden my phone rings. Hey, I was reading  
6 what you sent me, and what you just said, that can't  
7 be right, but I believe this. Well, that means he's  
8 been reading everything I've been sending him, right?

9                   So we start having a conversation, and the  
10 conversation goes real similar. He says Joe, I can't  
11 understand why the market people are making 4 percent,  
12 but you're saying this fund is making 7 percent, but  
13 most advisors, most people are making 4 inside the  
14 same fund. I said well, most guys get emotional about  
15 their money, and when things go bad they tend to  
16 react. They retract. They pull back. They change  
17 funds.

18                   They do something that normally can be  
19 detrimental to returns, and if you're doing it without  
20 advice it's more likely that it's going to happen to  
21 you than with me talking to you. He said well, I  
22 don't always agree with that. I said well, how much  
23 money do you have in cash right now? He froze. Point  
24 taken. I said if you didn't have that money in cash,  
25 how much money would you have right now? He said how

1 much money can I invest with you?

2 So he's a guy that was a robo-guy, an online  
3 guy that took time to realize the value of an advisor  
4 and to buy a mutual fund that cost .67 than one that  
5 costs .25 was very valuable, maybe 2 or 3 percent more  
6 valuable in end returns.

7 I'll talk about 401(k)s because that's  
8 something I know you guys are concerned with,  
9 rollovers and 401(k)s. I have a 401(k) plan with  
10 Voya, and it's a new plan for us, a start up plan, and  
11 it's got about a hundred employees in it. And so we  
12 had education meetings, did all the same things we do  
13 every time, spend all the time with them, no up front  
14 fees, new plan and all those things and told them if  
15 you have things you want to roll over or look at to  
16 move to this plan let me know.

17 So I get a call the other day from one that  
18 says Joe, I've got an old plan from the Dallas Fire  
19 and Police Association I want to move over. I said  
20 well, let me look at it before we do that. We look at  
21 cost, we look at fee structure, we look at returns in  
22 investments, we look at risk in investments, we look  
23 at the ability to navigate through their portal and  
24 their plan website, all these things. Are you getting  
25 advice? All those things add into the picture. Fees

1 and expenses is the big one.

2 We look at all that, and when we looked at  
3 all that I said you don't need to move that plan.  
4 It's a lot cheaper than we are because there's so many  
5 assets in that plan it keeps the cost down. So I said  
6 you need to stay there right now, and the reason you  
7 need to, unless you just don't have access to it, but  
8 luckily Voya marries the two so she can see them all  
9 on one website. So it's great for her. I said we  
10 don't need to move that over.

11 That's the kind of advice we give people  
12 because all my revenue is not generated from  
13 investment sales. My revenue is generated in part by  
14 investment sales, but primarily by my insurance  
15 business. We're the rogue element in the industry,  
16 and you need to study us to see what we do because  
17 what we do is really what you guys are trying to  
18 accomplish, and I encourage you to do that.

19 A last one, and then I'll finalize. I had a  
20 lady yesterday before I left call me and said Joe,  
21 I've got to get out of my investments. My husband  
22 told me to call you and get you to sell me a  
23 guaranteed annuity. Her words. Sell me a guaranteed  
24 annuity. I hear them on the radio all the time, and I  
25 got to have one. I got to have one right now because

1 Greece just went bankrupt and China is going bankrupt  
2 next week.

3 And so I said calm down, Cathy. Calm down,  
4 okay? We've been doing this for 15 years, and you've  
5 accumulated \$100,000 in your account just by doing  
6 what we're doing even through bad times, right? She  
7 said yeah. I said Greece is small. It's irrelevant.

8 It's good talking points, okay? Don't worry about  
9 China. So we got to that point through it all and so  
10 they're coming in next week, but she knew that was not  
11 the wrong thing, but for me that's \$5,500 in  
12 commission versus 200 bucks a year I make off her if I  
13 sell the annuity. It's not in her best interest.

14 In closing, I'll talk real quickly. Where  
15 the Department of Labor is concerned, Farmers is  
16 committed to working constructively with you guys to  
17 improve the current proposal and achieve investor  
18 protection. That's what we want to do. Farmers  
19 already works on our belief in the best interest of  
20 our clients. I mean, I just would dare anybody to  
21 challenge what we do and look at what we do on a daily  
22 basis.

23 So I would ask you guys really, and when I  
24 say this I say it sincerely. Challenge us. Ask us  
25 questions. Use us. Please, please, please study what

1 we do. We are not your normal investment or insurance  
2 company, and there's nobody that does it the exact  
3 same we do. We have a model that is hard to beat, and  
4 I've found that in any competition role, any  
5 competitive role I've been, I've found it's been hard  
6 to beat. Thank you for your time.

7 MR. HAUSER: Thank you.

8 MR. THISSEN: Good morning. My name is  
9 Richard Thissen. I'm the president of National Active  
10 and Retired Federal Employees Association. On behalf  
11 of the five million federal workers and annuitants  
12 represented by the National Active and Retired Federal  
13 Employees Association, I appreciate the opportunity to  
14 express our support for the Department of Labor's  
15 conflict of interest rule proposal.

16 NARFE believes the proposed rule will  
17 protect the individuals, including federal employees  
18 and retirees, from receiving unsound retirement  
19 investment advice. If finalized, the rule should  
20 result in better investments, lower fees and therefore  
21 lead to greater returns on the hard earned retirement  
22 savings of millions of Americans.

23 NARFE is particularly concerned that federal  
24 employees and retirees, as well as uniformed service  
25 members, invested in low-fee, thrift savings plan

1 funds currently are not adequately protected from bad  
2 financial advice regarding their TSP holdings.  
3 Because rollovers are not covered by the existing  
4 definition of fiduciary investment advice, financial  
5 advisors may legally recommend that account holders  
6 roll over their TSP holdings into an IRA where the  
7 money could be invested in mutual funds providing the  
8 same or essentially similar products.

9 For example, money could be moved into an  
10 S&P 500 index fund for as much as 20 times the cost of  
11 the C fund, the TSP's S&P index fund. Due to  
12 economics of scale, the TSP funds charge very low  
13 administrative fees, on the average .029 percent, that  
14 are far cheaper than alternatives that provide the  
15 same or essentially similar returns.

16 The defined contribution thrift savings plan  
17 is the primary means of retirement savings for most  
18 federal employees. It is also open to members of the  
19 military looking to save for their future beyond their  
20 military pension. For servicemen and women who serve  
21 less than 20 years, the TSP may be their only  
22 retirement savings while in uniform.

23 Nearly half of all current active duty  
24 uniformed personnel or more than 700,000 individuals  
25 are invested in the TSP. This number is growing we

1 think with each passing year and does not include  
2 those with balances who have since separated from the  
3 military.

4 The TSP offers the same types of savings and  
5 tax benefits that many private corporations offer  
6 their employees under 401(k) plans. Frequently hailed  
7 as one of the best managed retirement plans in the  
8 world, it boasts more than 4.7 million participants  
9 and a balance of more than \$454 billion. The  
10 importance of protecting this substantial balance of  
11 retirement savings for both federal civilian employees  
12 and retirees, as well as current and former members of  
13 the military, is profound, yet the lack of legal  
14 protection is having real world implications.

15 In fact, as reported by the *Washington Post*,  
16 when a former federal employee and pension expert went  
17 undercover to seek advice regarding his TSP holdings,  
18 eight of nine major investment firms told him to roll  
19 over his TSP funds into IRAs providing the same or  
20 similar investments to the TSP for a substantially  
21 higher cost. This is the very definition of bad  
22 advice. Even though it meets a suitability standard,  
23 it meets the need of the advisor and not the investor.

24 While there are some legitimate reasons to  
25 roll over TSP holdings into an IRA, in most cases

1 federal employees and retirees are better off leaving  
2 their money in the TSP, yet more than 50 percent of  
3 the TSP participants remove their funds from the TSP  
4 within a year when they are separated from service.

5 In 2013, separated participants, those who  
6 retired or otherwise left federal service, transferred  
7 \$9 billion out of the TSP into other financial  
8 institutions. Most, if not all of this \$9 billion was  
9 moved into accounts with much higher administrative  
10 fees than the TSP. The question is why.

11 We believe it speaks strongly to the  
12 prevalence of the bad advice that federal employees  
13 and retirees are receiving. We have heard from many  
14 NARFE members who have removed their money from the  
15 TSP only to later regret the decision. In response to  
16 a survey request from our members, here are a few  
17 examples of what they had to say.

18 Upon advice of my Merrill Lynch financial  
19 advisor, I transferred my TSP to an IRA at Merrill.  
20 Merrill sold me two annuities with my money. I would  
21 have done better with the TSP and the C fund. Be  
22 careful. There are advantages to transferring a TSP  
23 to a retirement account, but the TSP is hard to beat.

24 Another said I did not receive any  
25 information prior to my withdrawal. I received very

1 bad advice from a financial advisor regarding my TSP.

2 In hindsight, I would have probably left the TSP in  
3 place.

4 A third said I retired in January 2008 and  
5 chose to withdraw the full amount of my TSP account in  
6 November 2011. The money was invested, but it has  
7 grown only 9 percent as compared to the TSP C, S and I  
8 funds, which have averaged an increase of 18 to 26  
9 percent. I regret not staying in the TSP program.

10 In other words, bad advice is clearly a  
11 problem, and this is just from those who were able to  
12 recognize that they made a poor decision. Many others  
13 may be paying more for similar products unnecessarily  
14 without even knowing it.

15 NARFE has considered the counterarguments  
16 being made against the proposed rule by some in the  
17 financial services industry and found them lacking.  
18 In many cases, financial industry representatives  
19 claim they support a best interest standard in one  
20 breath, only to reject the idea of implementing it in  
21 the next. They claim that advice is and should be  
22 made in the client's best interests, but if they are  
23 actually held to that standard they no longer would be  
24 able to provide the same advice. If that is the case,  
25 we question whether that advice is worth paying for.

1                   With regard to advice regarding transferring  
2 TSP accounts into IRAs where participants would be  
3 paying higher fees for a similar product, we certainly  
4 do not believe it is. Additionally, NARFE does not  
5 view as credible the claim that small and middle  
6 income clients will no longer have access to  
7 investment advice if this rule and exemptions are  
8 implemented.

9                   We believe that the Department of Labor has  
10 taken a practical and flexible approach by providing  
11 exemptions designed to accommodate a range of existing  
12 and evolving business and compensation models,  
13 including commission and fee-based compensation. Some  
14 financial industry representatives claim these  
15 exemptions are unworkable. Here again, what they seem  
16 to be saying is it would be unworkable to provide  
17 advice that is in the best interest of their clients.

18                   It is time to close the loophole in the  
19 definition of a fiduciary and ensure that anyone who  
20 offers retirement investment advice is held to a high  
21 standard. Americans who have worked hard to save for  
22 retirement deserve investment advice that puts their  
23 financial security first. For these reasons, NARFE  
24 supports the proposed rule and asks the Department of  
25 Labor to finalize it.

1                   Thank you again for the opportunity to share  
2                   our views.

3                   MR. HAUSER: Thank you. Mr. Callahan, our  
4                   proposal does not, unless you can show me in the text,  
5                   we don't prohibit the sale of annuities. We don't  
6                   prohibit people from using brokers. We don't have  
7                   language saying that cheaper is always better. You  
8                   know, we don't either prohibit a broker model or say  
9                   that a broker model is inherently, you know, better or  
10                  worse than a fee-based model, yet I at least was  
11                  hearing you say essentially that we do all of those  
12                  things.

13                  So since nowhere in the text do we say any  
14                  of those things I have to think you think there's  
15                  something that makes our proposal not work, and I  
16                  guess I'd like to know what you think that those  
17                  things are.

18                  MR. CALLAHAN: I mean, I would say that,  
19                  agree with you that there is not an express statement  
20                  of those things, but as a matter of function they in  
21                  many scenarios virtually are not usable or else we  
22                  wouldn't need exemptions for them if they weren't  
23                  prohibited.

24                  So I would start with the notion that they  
25                  are prohibited, not expressly stated annuities, but

1 the fact of self-dealing, unlevelized compensation.  
2 That's why FINRA's comment letter says this is not  
3 business neutral.

4 The point that it isn't as simple as we can  
5 do this, that there's a lot of question, and that is  
6 why we need to create these exemptions, and then when  
7 you dig into the exemptions now we've taken an old  
8 exemption, 84-24, and we've split out variable  
9 annuities so we have two different paths for the  
10 income annuities that we're talking about.

11 And when you go through the function of  
12 applying those I'm just suggesting that by and large  
13 in the marketplace we've made those far more difficult  
14 to access. Some people will choose not to offer them  
15 and so the end result would be that consumers don't  
16 have as much as they would.

17 MR. HAUSER: So, let's, you know, I've asked  
18 this question of a number of people, but putting aside  
19 all the other features of the exemption, suppose and  
20 we'll get back to education in a minute --

21 MR. CALLAHAN: Sure.

22 MR. HAUSER: -- but, you know, at its core  
23 what the exemption, the best interest contract  
24 exemption contemplates is that you agree up front with  
25 your customer that when you made a specific investment

1 recommendation it was going to be in the customer's  
2 best interest. It was going to be prudent.

3 The fees are going to be reasonable in  
4 relationship to the product and services that you  
5 purchased and that you have policies and procedures in  
6 place to make sure that the representative both is  
7 going to adhere to those norms and that they're not  
8 incentivized to violate those norms. Now, from your  
9 standpoint does any of that make the broker model  
10 impossible or unworkable?

11 MR. CALLAHAN: I think when you read through  
12 it, it's not quite that simple. And I would also  
13 say --

14 MR. HAUSER: Well, but I'm asking suppose  
15 that was my proposal. At that point is that something  
16 you think is incompatible with a broker model and, if  
17 so, why?

18 MR. CALLAHAN: You know, in theory maybe  
19 not, but it's hard for me to comment specifically on a  
20 hypothetical scenario. I would say that we do have in  
21 place 84-24 as an exemption as it stands today and  
22 have for a long time to do those very things,

23 And I would just question if going through  
24 this additional standard on top of the SEC and the  
25 confusion I talked about, and whether we agree or

1 disagree the fact that we have questions on loss of  
2 access and put all these things together and say is  
3 that cost or risk worth the incremental benefit picked  
4 up when we have an exemption that, as I read it to be  
5 currently, does exactly what --

6 MR. HAUSER: Why doesn't the proposal reduce  
7 the level of confusion? You know, there's a fair  
8 amount of literature at this point that suggests that  
9 investors think when they deal with advisors that  
10 they're getting advice from an investment professional  
11 that it's in their best interest. I think your  
12 testimony was that's the kind of advice you give.  
13 That is their expectation. I suspect most investors  
14 would be surprised to learn that no, you actually  
15 don't hold yourself to that standard.

16 So to the extent that we essentially are  
17 saying no, no, if you're giving advice to a retirement  
18 investor that's going to need to be prudent. It's  
19 going to need to meet this best interest standard.  
20 Why aren't we in fact aligning the expectations of  
21 your customer with, you know, the standard? Doesn't  
22 that reduce confusion?

23 MR. CALLAHAN: I would say the confusion,  
24 there's two parts, the confusion and then the  
25 standard. I would say it does not reduce confusion

1 because now there's a new fiduciary definition, and  
2 for many of our clients, as I mentioned in my remarks,  
3 they already have an IRA overseen by the SEC and so it  
4 sounds very simple to say well, you're already a  
5 fiduciary. Isn't this easy? No, it's not. It's two  
6 totally different definitions.

7           Applying something built for the corporate  
8 retirement plans now into the individual retirement  
9 account space for the first time, overlapping what the  
10 SEC does, and I just mention that there are points  
11 already, just one, where these conflict and what they  
12 would challenge us to do, so I'm not sure how adding  
13 another standard with a different definition than  
14 already exists somehow makes things less confusing for  
15 clients.

16           I would argue that it's more and then these  
17 exemptions and now we're splitting the exemption into  
18 a path for annuity that's registered or annuity that's  
19 nonregistered, so you have two different paths to an  
20 exemption of two different standards. I don't think  
21 that's more clear.

22           But I would say in supporting the goal, and  
23 this is kind of what I want to get back to. Debating  
24 studies or hypothetical language, I'm not a regulator.  
25 I admit that. But I work with clients and advisors

1 every day, and I think what would be helpful rather  
2 than creating this new standard that I just talked  
3 about, this confusion that gives us admittedly you  
4 could argue stronger remedies on the back end to  
5 unwind these deals, if we're really serious about  
6 helping consumers on the front end how do we help  
7 prevent them from doing things that they would need to  
8 unwind?

9           And I would say if you build on what you've  
10 done with 408(b)(2), apply that down at the  
11 participant level, on one piece of paper tell them  
12 even in this example that here's the current fund that  
13 you have, here's how much it costs, and it's basically  
14 an index fund in your example, and then beside that on  
15 one piece of paper was here's basically the same fund  
16 and we're going to do the same level of service, but  
17 it's going to cost you in that example 20 times more.

18           That's simple. That's something where I  
19 would see -- I don't know what nine out of 10 of them  
20 would have done, but I bet a number of them would have  
21 looked at that on one page and said boy, why would I  
22 pay 20 times more to get the same exact thing? And  
23 what we're talking about is this best interest  
24 standard. It's confusing.

25           There's thousands of pages equivalent of

1 documents on a website they can go and review, and I'm  
2 just saying in function if what we really want to do  
3 is help consumers on the front end prevent deals that  
4 we end up having to unwind, I would strongly be in  
5 favor of something on one page that boils it down to  
6 all of this.

7 MR. HAUSER: Right. Yeah. I mean, you  
8 would support some species of disclosure, although not  
9 the disclosure that we've, you know, proposed in this  
10 regulation. And disclosure may well be helpful. We  
11 thought so, and we made some specific disclosure  
12 recommendations.

13 But why isn't it also good for the investor  
14 that you be obligated to give advice that's prudent  
15 and that isn't, you know, biased by the particular  
16 advisor's own financial interest? Why is that a bad  
17 thing?

18 MR. CALLAHAN: We do have that, the SEC.

19 MR. HAUSER: Well, I guess you don't have  
20 that to the extent you're subject to a suitability  
21 obligation and not to a fiduciary conduct standard,  
22 and while I appreciate your observation that you'd  
23 prefer the Securities and Exchange Commission be, you  
24 know, responsible for regulating in this space the  
25 fact is that the Employee Retirement Income Security

1 Act and the Tax Code give the Department of Labor the  
2 responsibility to recommend, to regulate investment  
3 advice, and it imposes a separate regulatory regime  
4 that's different than the securities law regime.  
5 That's built into the statute.

6 The SEC could not write a rule defining who  
7 is a fiduciary for purposes of ERISA or the Tax Code  
8 nor could they write the exemptions because they don't  
9 have that authority. That's our authority and our  
10 responsibility. Nor can the SEC write rules with  
11 respect to some products that are not securities.

12 So, I mean, we have an obligation certainly  
13 to coordinate our work with other regulators, but we  
14 have a separate regulatory regime, a separate set of  
15 responsibilities that's baked into the statute, and  
16 the question really is just why does, you know, asking  
17 you to adhere to a standard of prudence and of not  
18 giving conflicted investment advice or at least having  
19 policies and procedures that mitigate those conflicts  
20 and don't incentivize your representatives to act in  
21 ways that are contrary to the customer's interest, why  
22 is that an inappropriate exercise of that authority?  
23 Why is that a bad thing?

24 MR. CALLAHAN: Well, I mentioned we do have  
25 that with the SEC, but to go with this further, your

1 question, it's not so much that having the standard is  
2 the problem. It's the lack of definition around it.

3 So a fiduciary under the SEC is defined as  
4 one thing under the Advisors Act and then we have a  
5 new standard under ERISA, and for the first time we  
6 will be moving the standard out of the corporate  
7 sponsored plan into the individual retirement account,  
8 and what this standard has with it are things known as  
9 prohibited transactions, the very things that prohibit  
10 the use on the surface, and that's why we need  
11 exemptions.

12 But the income solutions that we talked  
13 about in the GAO study, and I'm just simply suggesting  
14 that the role in saving money in a qualified plan is  
15 different than the role of distributing money  
16 postemployment, and the risks that you're managing  
17 with sequence of return and longevity risk, and the  
18 SEC rule does not have with it the same level of  
19 ERISA's prohibited transactions designed for that  
20 previous framework.

21 When you parlay them over, now we've got the  
22 situation where a lot of the tools that are used are  
23 prohibited and now we're working backwards to carve  
24 them out, and I guess on my premise I'm just  
25 suggesting that is there not an opportunity rather

1 than adding on this layer and figuring out how we  
2 continue to peel this onion back, could we not use the  
3 existing framework that's in place and be pragmatic  
4 about helping consumers have the information that they  
5 need up front on a simple, one-page document that can  
6 help them in their decision making rather than give  
7 them this ability to unwind it in the future under a  
8 higher standard? I'm just not sure it's as practical  
9 as the other.

10 MR. HAUSER: Well, don't you think your  
11 people go to you because they're looking for  
12 expertise? I mean, they go to their representatives.  
13 Expertise that they don't have. Isn't that rather  
14 the point?

15 So just to say I'm just going to give you  
16 some disclosure on what the fees and the structure  
17 are, that doesn't seem like it gets it. It seems like  
18 what people need is actual recommendations that are in  
19 their interest.

20 MR. CALLAHAN: That makes it seem like the  
21 choice is having regulation or not. That's not.  
22 That's a false choice. The reality is that we do  
23 this.

24 And I mentioned more than half our business  
25 is under a fiduciary regime to do what's in the best

1 interest, but in the scenario where you're using these  
2 products that are overseen by -- products that are  
3 registered with the SEC, overseen by FINRA, it's a bit  
4 unfair to quantify that as not doing anything that is  
5 in favor of protecting the client. That's a robust  
6 regime.

7 And I would argue as someone who operates  
8 under both it is more rigorous getting money into a  
9 broker dealer regime than it is a best interest  
10 regime, and that's part of the reality of kind of  
11 busting this myth, as I did, that the SEC says fees  
12 are always better or they say it's not.

13 Let's say the best interest standard we all  
14 go to bed at night feeling good about there's a best  
15 interest standard. I'll tell you in practice, in  
16 terms of actually helping consumers make better  
17 choices it's easier to put money in a best interest  
18 standard solution than it is into a registered FINRA  
19 framework. And I would ask the question. You know,  
20 Bernie Madoff, which regime was he under?

21 MR. CANARY: Thank you.

22 MR. CALLAHAN: Best interest regime.

23 MR. CANARY: Let me switch gears on you a  
24 little bit, but maybe I'll start with the Farmers  
25 business model. A couple of questions. From the

1 sounds of the way that you interact with your clients,  
2 you may not really have a lot of experience with this,  
3 but I have asked other panelists about dispute  
4 resolution systems that are alternative to the FINRA  
5 model for dispute resolution.

6 So if you were dealing with one of your  
7 customers in a circumstance where you wouldn't be  
8 subject to a FINRA arbitration sort of ADR system,  
9 what is the dispute resolution process that you go  
10 through?

11 MR. WIMPEE: You're correct. I don't know.

12 MR. CANARY: Okay.

13 MR. WIMPEE: I haven't had that happen. In  
14 1,600 clients, I've never had one have an issue, but  
15 FINRA is there for that reason.

16 MR. CANARY: Okay.

17 MR. WIMPEE: I mean, so yes. I don't know  
18 what the resolution would be.

19 MR. CANARY: All right.

20 MR. WIMPEE: Can I touch real quickly on  
21 something? I want to agree that what he's talking  
22 about going on is bad. That's not what anybody wants  
23 to happen, and those people should probably -- is  
24 there a reason for them to roll out? There could be,  
25 but expense is not the only reason.

1                   Do they need income? Do they have an  
2                   advisor? Do they have somebody to talk to? Do they  
3                   know what they're doing? Are they planning on leaving  
4                   the money to their grandkids? What are they trying to  
5                   do? If there's different reasons for why they want to  
6                   roll out, let them make the determination if they want  
7                   to drive a Cadillac or drive a Yugo. They get to pick  
8                   what they drive. But if they have clear disclosure I  
9                   do agree a one-page clear piece of disclosure is a  
10                  starting point that allows me then to give them good  
11                  advice.

12                  Look, you're going to be better off. If  
13                  you're just going to keep the money here and not do  
14                  anything and you've got a pension and you just want it  
15                  to grow, leave it right there. There's no reason to  
16                  move it. But if you're saying I need the income out  
17                  of it I'm not sure if they have income options that  
18                  can be put out of it. I don't know what their  
19                  mechanics are. I don't know, so we need to  
20                  investigate that.

21                  If you're going to leave it to a grandkid  
22                  you may want to put it in some kind of contract that  
23                  gives you a guaranteed return that guarantees a death  
24                  benefit. I don't know, but they need to be able to  
25                  pick that. And if they would have had that one-page

1 disclosure instead of all these people calling, nine  
2 out of 10, I bet that number would have been down to  
3 very little of nothing because they would have slowed  
4 down the process.

5 But a single page disclosure works in 401(k)  
6 plans. It is starting to work. I see that in the  
7 401(k) industry two years into this process. The  
8 industry is changing the way they build their plans.  
9 They're removing all the fees. They're cleaning it  
10 up.

11 There's two providers out there who have  
12 already gone that way, and they're capturing market  
13 share and everybody else is going to have to catch up  
14 because now they've stripped it down, no revenue, no  
15 commissions, no anything built in the fund. So now  
16 it's just clear management fees and then they bill an  
17 asset charge for everything else. It's easy to  
18 understand. It's easy to explain to the fiduciaries  
19 and the companies.

20 So that kind of concept does work. If  
21 you'll give us the tools that are simple and not  
22 regulate us to a point where it forces me to change my  
23 business model and charge more to build and follow  
24 regulation, why I'm I then going to pass that cost on  
25 to who? Consumers. The consumers end up paying more

1 for services they already can get. I just don't want  
2 to see that happen. That's my fear. My fear is I  
3 don't want consumers paying more than they are, but  
4 get good advice currently.

5 MR. CANARY: So let me just follow up --

6 MR. WIMPEE: Yeah.

7 MR. CANARY: -- on that. I think that's  
8 very helpful. It seems like the rule that would make  
9 you a fiduciary for providing investment advice is not  
10 where you're concerned. The best interest standard,  
11 being a fiduciary, being subject to prudence and  
12 loyalty requirements are not your issue.

13 Your issue is you're concerned about maybe  
14 the exemptions or regulatory compliance cost, which  
15 are going to make it harder for you to operate in your  
16 existing business model. Is that right?

17 MR. WIMPEE: Correct.

18 MR. CANARY: Okay.

19 MR. WIMPEE: And in our letter it does state  
20 what we think and some ways we can modify and correct  
21 and help you guys any way we can to give you real  
22 world situations and how we think it can still better  
23 help consumers. We have that in our written, so --

24 MR. CANARY: Okay. And one element of your  
25 testimony seemed to be a focus on the fact that your

1 business model and your revenue stream is not really  
2 dependent upon investment advice. It's that you're  
3 providing other kinds of insurance services -- auto,  
4 home, whatever.

5 Are you asking us to consider or suggesting  
6 we look at the idea of a limited set of like exemption  
7 conditions if your business model was not reliant upon  
8 investment generated revenue streams?

9 MR. WIMPEE: Yes, sir. I think that is  
10 actually in the written, that verbiage you just used,  
11 and I'm glad that it came across in our concept.  
12 Because what happens, it gives me the ability to be  
13 nonemotional.

14 What happens is with most advisors, and  
15 they're all good people. This isn't something that  
16 we're villainizing the Merrill Lynches of the world or  
17 any fee-based guy or any guy that's an annuity guy or  
18 anything else. That's just what they do and so they  
19 have to generate revenue to pay for the kids and their  
20 family and their shoes and their food.

21 Well, mine is paid for by something else  
22 already. If I don't sell another investment product  
23 the rest of my life, my lifestyle does not change.  
24 Where that's beneficial to you guys if you are my  
25 clients is that Joe is truly not emotional about the

1 money. He's not worried about losing a client and  
2 losing \$5,000 in revenue a year off of you. I'm  
3 worried about you losing money and making bad  
4 decisions.

5 And by doing that I can testify today that  
6 in the 14 years I've been doing this I think I've lost  
7 one client in 14 years. One. It's because we educate  
8 up front. We tell them what's going to happen. We  
9 give them advice as market conditions are going to  
10 come and go, but we want them to be steady and patient  
11 with what they're doing, and we will change our model  
12 with them when they get to a point where they can't  
13 tolerate risk anymore or they can't sleep at night.

14 And then they need to draw us back and pull  
15 us back to more conservative investments like  
16 annuities and other pieces that fit them in retirement  
17 needs a lot better in the long run, but in early  
18 stages we just believe that regular A share mutual  
19 funds make a -- they work. They work.

20 MR. CANARY: Thank you. Mr. Callahan, a  
21 couple of questions for you.

22 MR. CALLAHAN: Sure.

23 MR. CANARY: I think the last panel we were  
24 talking about whether or not the rule should cover  
25 life insurance to the extent that life insurance has

1 an investment component. Do you have a view on  
2 whether life insurance as a welfare benefit program or  
3 welfare benefit should be not covered by the rule even  
4 if the life insurance contract has an investment  
5 component?

6 MR. CALLAHAN: I go back to building upon  
7 the existing regulatory structure. I could talk to  
8 our membership to see exactly how that would play out,  
9 but I'm not sure that again what we're talking about  
10 is quantifying the problem that we're solving, and  
11 again we're building in this whole secondary regime  
12 and we're spending all this time and days talking how  
13 we carve back and peel out. I'm just suggesting --

14 MR. CANARY: Okay.

15 MR. CALLAHAN: -- if we're really trying to  
16 help consumers in their decision making I'm not sure  
17 this is the most pragmatic approach.

18 MR. CANARY: Okay. One other question. I  
19 think you were raising some concerns about the fact  
20 that the structure with PTE 84-24 versus the best  
21 interest contract and it has two avenues --

22 MR. CALLAHAN: Sure.

23 MR. CANARY: -- for dealing with annuity  
24 products. I think what part of that was is that the  
25 best interest contract provision was dealing with the

1 annuity products that are securities --

2 MR. CALLAHAN: Right.

3 MR. CANARY: -- and 84-24 was designed to  
4 deal with those that are not. So explain to me if you  
5 could a little bit. It seems like there already is a  
6 regulatory structure that differentiates those. If  
7 you're dealing with an annuity that's not a security  
8 it's primarily regulated under state insurance  
9 provisions where the variable annuity may be both.

10 MR. CALLAHAN: It is both.

11 MR. CANARY: So why is our following that  
12 kind of a division a problem?

13 MR. CALLAHAN: Yeah. I was just answering  
14 the question about why it doesn't reduce confusion.  
15 That's why I said that.

16 MR. CANARY: All right.

17 MR. CALLAHAN: But it doesn't. It's the  
18 same, as you just said. But I do think it's an  
19 important point though, carving them out separately.

20 Again, you can define it certain ways, but  
21 in practice if you look at the FINRA regime of using a  
22 variable annuity versus the state insurance regime of  
23 using a fixed or indexed annuity, the FINRA regime is  
24 far more robust, and to build a rule designed to  
25 protect consumers and then carve out the least of the

1 regimes as an easier path, I don't understand at the  
2 end of the day how that helps the customer.

3 MR. CANARY: Thank you.

4 MR. COSBY: Yes.

5 MS. HALL: Go ahead.

6 MR. COSBY: Okay. I had a question for Mr.  
7 Wimpee. Thanks for your testimony. It was really  
8 good to hear your anecdotes from the front line  
9 working with investors. You mentioned that you had a  
10 business model that worked well that you wanted us to  
11 study more, so I just had a question related to that.

12 I was curious about how the compensation  
13 structure works with Farmers Financial Solutions. Is  
14 there variable compensation involved in the products  
15 that you recommend, or is it a flat fee basis type of  
16 situation?

17 MR. WIMPEE: I'll kind of give you a concept  
18 of it, and if I answer your question hopefully I do  
19 correctly. But basically we don't have a mechanism to  
20 charge a fee, so our broker dealer, our platform, we  
21 couldn't charge you a holding fee if we wanted to. We  
22 don't have a mechanism to do that. That's one of the  
23 problems if this changes. It will force us to create  
24 all that mechanism, and we don't want to do that.

25 We live off of whatever the commission

1 structure is built inside the products that we sell --  
2 mutual funds, our annuities; the majority of it is  
3 mutual funds -- that are already in place and have  
4 been in place for years, and most mutual fund  
5 companies are pretty generic about that compensation  
6 so there may be an A share, a C share, a B share, but  
7 we primarily believe -- at least I do; I'll speak for  
8 myself -- that A share mutual fund transactions  
9 typically are the best place for an investor to buy,  
10 get the expense out of the way initially, then buying  
11 at a very low operating cost as it on goes.

12 So we're receiving an up-front commission no  
13 matter what it may be in the A share, and it reduces  
14 as the assets get larger of course, and then we're  
15 receiving an ongoing trailer, about a .25, which  
16 whatever the 12(b)(1) fees that are built into the  
17 mutual fund family currently. So, for instance, a  
18 \$100,000 investment for me generates about \$195 a year  
19 in commissions. My million dollar client is about  
20 \$2,000 a year in commissions.

21 And so that's kind of our basis points  
22 compared to a fee-based guy that may be for that same  
23 million dollar guy may be making \$12,500 or something.  
24 I'd soon the consumer keep that \$10,000 and not give  
25 it to me. Two things. It helps their accounts, helps

1       them pay for college, helps them do whatever, but it  
2       helps me to be nonemotional. That's the biggest thing  
3       that we run into is the fear of us doing these things  
4       as we get emotional about our money.

5                   And sometimes if somebody is going to give  
6       me \$6,000 or \$8,000 to do a transaction I can tend to  
7       go that way. That's your fear, right? Our model  
8       keeps us from doing that, and that's what we want to  
9       protect because we believe it's very valuable to the  
10      consumer, and it's proven to be that.

11                  MR. COSBY: I just had a follow-up question.  
12      What's the percentage of your business that's  
13      allocated toward insurance and investments?

14                  MR. WIMPEE: Every Farmers agent is a little  
15      different. I'm one of the larger ones in that, and  
16      mine is probably 25 percent revenue in the investment  
17      side and 75 percent, but probably the majority are  
18      10 percent. So they have the knowledge. They speak  
19      the same language I do. This is kind of how we train.

20                  I actually go around and train. I go for  
21      free state to state and help people learn how to do  
22      this the best way possible for free just to help other  
23      Farmers agents better suit their clients, help their  
24      clients retire properly and sustain their  
25      relationships with the auto and home customers so we

1 build more retention with them.

2 MR. COSBY: And is a lot of your business  
3 educational where you're educating your clients  
4 without specifically recommending products?

5 MR. WIMPEE: I would say all the initial  
6 meetings are always educational, and so what we're  
7 trying to do is let them know what the landscape is,  
8 let them know what an annuity is, what a mutual fund  
9 is, let them know what all these other products are.  
10 Ask them questions about what their needs are, what  
11 their concerns are, where they're trying to go, what  
12 their income levels are. The spectrum is across the  
13 board.

14 And then helping them make recommendations  
15 that will meet the specific goals they've laid out in  
16 the manner that fits their risk profile that they can  
17 tolerate. And sometimes that changes over the years  
18 so we will re-meet with them in three or four or five  
19 years. And I tell them don't call me. I always tell  
20 them, I say we're not going to meet every two years  
21 because what we've done works. The models are good.

22 But when you get nervous, I want you to pick  
23 the phone up and call me because I'm probably not  
24 nervous. I need to know when you're emotionally  
25 nervous that you're going to make a bad decision so I

1 can stop you or advise you or help you through the  
2 process. And so that's kind of our model.

3 MR. COSBY: Thank you. And I had a question  
4 for you, Mr. Callahan about your business model --

5 MR. CALLAHAN: Sure.

6 MR. COSBY: -- selling the lifetime income  
7 products. I worked on the regulatory impact analysis  
8 for the rule, and as you know there's a lot of  
9 literature on mutual funds and the compensation  
10 streams that are used and the distribution channels  
11 for those products. I was just curious about the  
12 lifetime income products.

13 How does the compensation structure work  
14 with those products? Again, similar to what I asked  
15 Mr. Wimpee, are there variable compensation streams  
16 there that can influence how the advisors advise the  
17 products?

18 MR. CALLAHAN: For the advisors, no. The  
19 way it's structured is, unlike his regime, we are both  
20 a fee-based and the commission-based and so in the  
21 mutual fund example most of the funds, while there are  
22 commission-based, there are fee-based is usually the  
23 solution that is used, particularly in the annuities  
24 base. Those are primarily not fee-based. Those are  
25 commission-based.

1                   But we do not manufacture any products.  
2                   We're independent, so based on which of those we sell  
3                   the compensation is filed with the SEC and approved as  
4                   a standardized commission schedule and then it's paid  
5                   out standardized.

6                   MR. COSBY:   And you said you weren't an  
7                   expert on what's going on in the U.K., but I did want  
8                   to clarify that the report that you mentioned, the  
9                   joint Treasury report with the FCA, there's been a lot  
10                  of review going on --

11                  MR. CALLAHAN:   Sure.

12                  MR. COSBY:   -- of what's been going on in  
13                  the U.K. since they implemented the retail  
14                  distribution review and so that report is just  
15                  something that's a standard report where they're  
16                  trying to investigate what's actually going on in the  
17                  marketplace, so I just want to clarify for the record  
18                  that that is what that was.

19                  MR. CALLAHAN:   Thank you.   Just again my  
20                  point was again not that it was an answer in and of  
21                  itself, but it would just seem to give reason to pause  
22                  and look to see what they do if it's ongoing, what  
23                  could be done.   You know, I'm here.   I don't want to  
24                  argue.

25                  MR. COSBY:   No, I understand.   I don't want

1 to argue either.

2 MR. CALLAHAN: But me, I'm here today to be  
3 on the record. I'd love to think that my testimony  
4 today is going to influence the outcome, but if I'm  
5 being totally candid I think the Department has made  
6 up its mind. I saw the Treasury or, I'm sorry, the  
7 Department Secretary's letter back to Representative  
8 Wagner that we're moving forward notwithstanding the  
9 letters you sent.

10 So I'd like to think I'm here to sway the  
11 outcome, but I'm not sure that it will, but I do want  
12 to be here to be on the record. I want to be on the  
13 record saying that what's happening in the U.K., or at  
14 least what they're examining, based on our own  
15 business model we met offsite a week ago and we've  
16 already made a decision if this rule moves forward how  
17 we will address it and where we will cut off access in  
18 the market to deal with the uncertainty and exposure.

19 And I just want to be on the record to say that in my  
20 opinion I'm confident that is what's going to happen.

21 MR. COSBY: Okay.

22 MR. HAUSER: Let me just, so we're going to  
23 let Joe Canary ask one last question, but, you know, I  
24 just want to make completely clear, because I don't  
25 want this lost in the shuffle. This is not about

1 brokers versus advisors. We aren't putting a thumb on  
2 the scale. Our aim is to permit all of these models  
3 to move forward.

4 The core of the exemption that would be  
5 available for brokers in particular even when they get  
6 conflicted payment streams is you agree up front with  
7 your customer essentially to do exactly what you said  
8 you do, and you do that in an enforceable way and when  
9 it comes to an individual claim you can do it through  
10 FINRA arbitration.

11 So this is not the U.K. We have not  
12 outlawed commissions. We are trying to do a very  
13 light touch regulation that by and large says you hold  
14 yourself out as giving best interest advice to your  
15 customers, and we'd like you to contract to do that.  
16 And to the extent there are operational and other  
17 issues we haven't made up our mind. We would love to  
18 hear from you. You tell us how to make this more  
19 workable.

20 But if what you're telling us is that it  
21 just doesn't work for us to make an up-front  
22 commitment to somebody that we're going to give advice  
23 that's prudent or in their best interest, I think that  
24 probably, you know, will take a little bit more of  
25 explaining.

1 MR. CALLAHAN: I would say that we are doing  
2 that, as I mentioned, under the SEC and that I would  
3 take you on your offer about how we can get practical  
4 about disclosing.

5 MR. HAUSER: Terrific.

6 MR. CALLAHAN: And I would say that while  
7 the goals as you just described them, I would agree  
8 with those goals, but that's not what this rule does,  
9 including the regulator of the regime that you said is  
10 not impacted. His own comment letter said it's not  
11 business model neutral.

12 So I just think that's important to note  
13 that their own regulator of that regime has said this  
14 is not true, but I agree with the goal.

15 MR. HAUSER: You mean FINRA?

16 MR. CALLAHAN: Correct.

17 MR. CANARY: So more of a request rather  
18 than a question for Joe and Farmers. Tim noted that  
19 part of an element of what we're trying to do is an  
20 up-front commitment in the form of a contractual  
21 undertaking.

22 So if you could in your supplemental  
23 comments talk about whether you have what you think is  
24 a contract with your customers, how that's formed, how  
25 it works for you. I think would be helpful because

1 we've had people suggest that we need to think about  
2 different ways of describing the contractual  
3 undertaking, and so I think your experience would be I  
4 hope particularly valuable in informing us on that.

5 MR. WIMPEE: We'll be glad. We'll get back  
6 to you on that for sure. Thank you.

7 MR. CANARY: Okay. Thank you.

8 MR. HAUSER: All right. Thank you all very  
9 much.

10 VOICE: Thank you.

11 MR. HAUSER: Panel 16, I think.

12 (Pause.)

13 MR. HAUSER: Mr. Cleary, whenever you're  
14 ready.

15 MR. CLEARY: Members of the panel, my name  
16 is Gerry Cleary. I am a senior vice president for the  
17 Northern Trust Company in Chicago, Illinois, and I  
18 provide regulatory and compliance support to our  
19 corporate and institutional services business. I  
20 appreciate the opportunity to be here today to  
21 represent the American Bankers Association regarding  
22 the Department of Labor's proposed regulation.

23 My testimony today will cover three primary  
24 concerns with the Department's proposal. First, the  
25 proposal's definition of recommendation and its

1 elimination of the existing mutual understanding  
2 requirement; second, the proposal's effect in the  
3 institutional marketplace; and, finally, the  
4 proposal's treatment of statements of asset values  
5 provided by bank custodians.

6 At the outset, ABA agrees that retirement  
7 services providers, when acting in a fiduciary  
8 capacity, should be subject to a best interest  
9 standard. However, ABA believes the Department's  
10 proposal is overbroad and captures many services that  
11 should not be treated as fiduciary investment advice  
12 under either ERISA or the Code.

13 If adopted in its current form, the proposal  
14 will make it extremely difficult, complex and costly  
15 for banks to deliver the investment-related products,  
16 services and information necessary to achieve a  
17 financially sound retirement. This will likely harm  
18 the very retirement investors the Department is  
19 seeking to protect by limiting their access to  
20 valuable investment information and services that  
21 should continue to fall outside ERISA's fiduciary  
22 framework.

23 Given the significance of the widespread  
24 concerns with the current proposal, we urge the  
25 Department to issue a revised proposal and allow for

1 additional public comment prior to issuing a final  
2 rule.

3 The three issues we've selected to discuss  
4 illustrate the compliance challenges banks would face  
5 under the current proposal. First, the proposal's  
6 definition of the term recommendation, combined with  
7 its elimination of the current mutual understanding  
8 requirement, resulted in an overbroad and unworkable  
9 definition of investment advice.

10 Based on existing FINRA guidance, the  
11 proposal broadly defines recommendation as a  
12 communication that, based on its content, context and  
13 presentation, would reasonably be viewed as a  
14 suggestion that the advice recipient engage in or  
15 refrain from taking a particular course of action.

16 Making a suggestion a basis for ERISA  
17 fiduciary responsibility is especially problematic  
18 given the proposal's elimination of the existing  
19 requirement that the recommendation be provided  
20 pursuant to a mutual understanding that it will serve  
21 as a primary basis for investment decisions and that  
22 it will be individualized based on the needs of the  
23 plan. Instead, the proposal merely requires that  
24 there be a mutual understanding that the  
25 recommendation is specifically directed to the advice

1 recipient for consideration.

2 Consistent with common business practice,  
3 benefit plans and retirement investors both realize  
4 that not every investment suggestion directed to them  
5 by their bank custodian constitutes investment advice  
6 that should be expected to comply with ERISA's  
7 fiduciary standards. Extending fiduciary status to  
8 any service provider who specifically directs an  
9 investment-related suggestion to a plan fiduciary or  
10 retirement investor would capture vast swaths of  
11 written and oral communications from banks that are  
12 clearly not acting as fiduciary investment advisors.

13 In fact, the proposal could be interpreted  
14 to capture within investment advice virtually any and  
15 every investment-related conversation with a  
16 participant, beneficiary, plan fiduciary or IRA owner.

17 This could include, for example, sales conversations,  
18 requests for proposals, discussion of new products and  
19 services, discussions of performance data and other  
20 communications that should fall well outside the scope  
21 of ERISA's justifiably strict fiduciary responsibility  
22 requirements.

23 Treating every such investment-related  
24 conversation or sales pitch as potential fiduciary  
25 investment advice will unnecessarily limit a plan

1 fiduciary's ability to obtain and consider  
2 information, analysis and viewpoints from multiple  
3 sources in making their investment decisions.

4           Rather than requiring that service providers  
5 comply with complex exemptions in order to make any  
6 investment suggestions to their retirement plan  
7 customers, the proposal should allow the parties to  
8 agree whether all investment suggestions will be  
9 treated as fiduciary investment advice rather than,  
10 for example, investment education or even mere data  
11 points for further consideration.

12           Indeed, plan fiduciaries and retirement  
13 investors often seek investment suggestions, market  
14 color and performance data in casual conversations  
15 with their bank custodians that neither side expects  
16 will rise to the level of fiduciary investment advice.

17           Because of its overly broad definition of investment  
18 advice, the current form of the proposal will only  
19 serve to cut off or stifle retirement providers'  
20 conversations with their retirement customers for fear  
21 that any such conversation could be deemed a fiduciary  
22 act that could result in a prohibited transaction or  
23 self-dealing violation.

24           Failure to narrow the definition to  
25 situations where both parties understand the service

1 provider is making bona fide, individualized  
2 investment recommendations that will be relied upon as  
3 a primary basis for investment decisions only inhibit  
4 retirement customers' ability to obtain and understand  
5 investment information. By promoting awkward and  
6 truncated investment discussions, the proposal is also  
7 likely to reduce customers' trust in their retirement  
8 providers' ability to respond to their investment  
9 needs and objectives.

10 In order to address these concerns, ABA  
11 believes the definition of recommendation should be  
12 revised to include only those communications that  
13 constitute a clear, affirmative statement of active  
14 endorsement and support for taking or refraining from  
15 a particular investment course of action.

16 In addition, the primary basis and  
17 individualized prongs of the mutual understanding  
18 requirement should be reinstated to make it clear that  
19 both parties must be aware that services include  
20 tailored investment advice that will serve as a  
21 primary basis for investment decisions. Otherwise  
22 service providers will either need to refrain from  
23 making valuable investment suggestions to their  
24 clients or face the potential penalties of  
25 unintentionally becoming an ERISA fiduciary.

1            ABA's second major concern is the proposal's  
2            needless insertion into the institutional retirement  
3            marketplace. The Department has focused much of its  
4            intention in media statements, Congressional testimony  
5            and regulatory analysis on the proposal's benefits in  
6            the retail marketplace without having analyzed the  
7            need for the proposal in the institutional  
8            marketplace.

9            There is simply no evidence that  
10           institutional plan fiduciaries are being  
11           systematically misled, disadvantaged or abused by  
12           banks or other service providers as they seek market  
13           information or viewpoints for their consideration in  
14           making their own independent investment decisions.

15           The Department's one-size-fits-all approach  
16           to applying strict liability provisions to all  
17           potential advice providers, no matter how  
18           sophisticated the customer, ignores the fundamental  
19           fact that institutional plan fiduciaries understand  
20           the environment in which they operate and the  
21           transactions they undertake.

22           Therefore, we believe the proposal needs to  
23           be modified to recognize the differences between  
24           unsophisticated retail investors who have limited  
25           sources of investment information and institutional or

1 other sophisticated investors. In particular, the  
2 proposal should recognize that institutional investors  
3 often rely on their own investment experts and are in  
4 no way expecting their custodian banks to act as ERISA  
5 fiduciaries every time they make a suggestion  
6 regarding their products or other investments.

7 In this regard, we note that FINRA Rule  
8 2111(b) clearly recognizes this distinction. This  
9 rule essentially eliminates the suitability  
10 requirement for sophisticated institutional investors  
11 who acknowledge they are exercising their own  
12 judgment. We urge the Department to make a similar  
13 distinction in the ERISA context.

14 Finally, we wish to address the proposal's  
15 inclusion of statements of value that are similar to  
16 appraisals or fairness opinions. As trustees and  
17 custodians of plans and IRAs, many banks provide  
18 recordkeeping and reporting services. These include  
19 periodic reporting of account statements that reflect  
20 the current prices of a retirement account's assets  
21 based on information obtained from third parties and  
22 pricing vendors.

23 Under the proposal, investment advice could  
24 be interpreted to include such statements if provided  
25 in connection with a specific transaction. ABA is

1 concerned that the inclusion of the words similar  
2 statement concerning the value of securities or other  
3 property, when read together with the associated  
4 carve-out, creates confusion with respect to routine  
5 reporting that is not legally required, such as  
6 periodic reporting of account assets and prices.

7 For example, a plan fiduciary may receive a  
8 trust accounting statement listing the current values  
9 of the plan's holdings and then decide to buy or sell  
10 particular securities based on information in that  
11 statement. Similarly, a plan participant or  
12 beneficiary may decide to enter into a transaction  
13 such as a transfer between investment options or a  
14 distribution based on the valuation information  
15 provided by the bank in the normal course such as a  
16 benefit statement, account information on a plan  
17 website or a response to a phone inquiry regarding  
18 current account values.

19 Such statements of account values are  
20 provided solely as factual information and are not  
21 intended as recommendations regarding a particular  
22 transaction. Accordingly, they should not be treated  
23 as fiduciary investment advice under the proposal.

24 The proposal's carve-out, which exempts  
25 statements of value solely provided for compliance

1 with legal reporting and disclosure obligations, is  
2 too narrow to afford protection for banks and others  
3 who routinely provide statements of values outside  
4 legally required reporting and disclosure. We  
5 therefore urge the Department to revise the proposal  
6 to exclude any statements of value that consist solely  
7 of objective financial data.

8 We sincerely hope the Department finds these  
9 comments to be helpful. Thank you for your time, and  
10 I'll be happy to answer questions later.

11 MR. HAUSER: Thank you. Mr. Valenti?

12 MR. VALENTI: Good morning. I would like to  
13 thank the U.S. Department of Labor for holding this  
14 week's hearings. My name is Joe Valenti, and I am the  
15 Director of Consumer Finance at the Center for  
16 American Progress in Washington, D.C.

17 Today we'll address the challenges workers  
18 face in planning for a secure retirement, the need for  
19 a strong rule to prevent conflicted retirement  
20 investment advice and some of the proposed rule's  
21 unfounded criticisms.

22 The stakes for workers and retirees today  
23 are far higher than they were four decades ago. When  
24 the current so-called suitability standard was  
25 established in 1975, nearly three-quarters of all

1 workers in a retirement plan were participants in  
2 defined benefit pensions. Today, most Americans'  
3 retirement savings lie instead in vehicles such as  
4 401(k) plans and individual retirement accounts or  
5 IRAs.

6 Families are largely on their own to make  
7 major investing and retirement planning decisions, and  
8 the record shows many of them have had great  
9 difficulty doing so. While most households have  
10 access to social security, many also rely on pensions  
11 and savings that are already weak. Among households  
12 age 55 to 64 with retirement plans, the median account  
13 balance is only \$104,000, which would only provide  
14 about \$5,000 in annual income as a life annuity.

15 Including households with no retirement  
16 savings at all, the median account balance drops to  
17 \$14,500. More than half of all working age households  
18 are now considered inadequately prepared for  
19 retirement, an increase from 31 percent in 1983. This  
20 risk is even higher for African-American and Latino  
21 households, those without a high school diploma and  
22 households headed by single women.

23 Consequently, it's important that families  
24 can turn to financial professionals to help them chart  
25 a course for retirement. However, such professionals

1 are only a benefit to families if they provide the  
2 best advice for the saver rather than for their own  
3 earnings. In other words, this advice must meet the  
4 highest standard for a relationship of trust, a  
5 fiduciary standard.

6           Unfortunately, the current suitability  
7 standard, which is four decades old, reflects a lower  
8 standard of care. It ignores the significant  
9 long-term consequences of even one-time advice and  
10 enables contracts to imply in fine print that these  
11 are not binding relationships of trust. As a result,  
12 broker dealers and others are able to market  
13 themselves as financial advisors or consultants  
14 without actually complying with the rules that  
15 normally govern such relationships.

16           Moreover, as has been frequently stated this  
17 week, savers enter into these contracts expecting them  
18 to signify fiduciary relationships. When families do  
19 turn to financial professionals, the suitability  
20 standard has major consequences for retirement savers  
21 through high fees and potential abuse.

22           The market for IRAs is a prime example.  
23 Today the \$7.4 trillion in IRA assets even exceed  
24 those in 401(k) plans. The vast majority of these  
25 funds come from rollovers when workers change jobs or

1 retire. As the Government Accountability Office  
2 recently found, workers leaving a job who sought  
3 advice were often highly encouraged to convert to a  
4 high cost IRA even if they could stay in their plan or  
5 move their savings to their new employer's plan.

6 As we heard earlier this morning, even  
7 workers in the federal Thrift Savings Plan or TSP, the  
8 lowest cost plan imaginable, have been subject to  
9 marketing disguised as advice. Nearly half of all  
10 federal employees take money out of the TSP when they  
11 leave the government, despite the fact that other  
12 plans have fees that are at least 20 times higher.

13 These migrations are extremely costly as  
14 fees compound over a lifetime. Even a 75 basis point  
15 or .75 percent difference in fees for a young worker  
16 could result in \$100,000 of additional fees across a  
17 lifetime. That's equivalent to working three  
18 additional years to achieve the same retirement  
19 income.

20 What's more, conflicted advice often carries  
21 significant consequences beyond excessive investment  
22 and plan management fees. Consider Elaine and Merlin  
23 Toffel of Illinois, whose story was reported last year  
24 in the *New York Times*. After meeting with brokers at  
25 their trusted local bank branch, they sold a portfolio

1 of low-cost investments, incurring tax consequences  
2 along the way, and invested most of their money in  
3 expensive variable annuities recommended by the bank  
4 with a 4 percent annual fee and a 7 percent surrender  
5 charge for accessing funds early.

6 The surrender fee made it difficult for the  
7 Toffels to use these assets to cover long-term care  
8 needs. An advisor acting in their best interest  
9 likely would have instead recommended very modest  
10 investment changes to rebalance their portfolio.

11 These abuses demonstrate the need for the  
12 Department of Labor's proposed rule. While a  
13 fiduciary standard would require market adjustments,  
14 giving conflict-free retirement advice is not in fact  
15 unworkable. Thirty million investors are currently  
16 served by registered investment advisors who manage a  
17 total of \$67 trillion under a legal obligation to  
18 serve the best interest of their clients, and  
19 increasingly firms are using technology to offer  
20 advice under a fiduciary standard at a fraction of the  
21 cost of the conflicted advice available today.

22 For just one example, Rebalance IRA reports  
23 that the average new customer coming from a brokerage  
24 relationship previously incurred an average total fee  
25 exceeding 2.37 percent per year. After becoming a

1 Rebalance customer, customers' fees declined on  
2 average by 68 percent. In any other industry this  
3 development would be called innovation or disruption  
4 rather than being dismissed as so-called robo-advice.

5 Many have argued that small savers' needs  
6 will no longer be met through the Department's  
7 proposed rule. As someone whose work focuses on  
8 consumer policies that support low and moderate income  
9 families, I disagree. Instead, I agree with Arthur  
10 Levitt, the former Securities and Exchange Commission  
11 chairman, who recently stated that, and I quote, "I  
12 think people of modest means are the ones who need  
13 this rule more than any other type of investor."

14 Industry warnings about losing access are  
15 often a red herring as we have seen in efforts to  
16 restrict predatory or misleading credit products such  
17 as high-cost mortgages and auto loans, and when  
18 families cannot achieve a secure retirement taxpayers  
19 collectively pay the price.

20 Some have also speculated that enhanced  
21 disclosures alone could address this need. Notably,  
22 the proposed best interest contract exemption contains  
23 several key disclosures that could potentially empower  
24 consumers to identify fees in a clear and  
25 comprehensible manner. CAP strongly supports

1 prepurchase disclosures that illustrate the effects of  
2 fees not just in one year, but also the consequences  
3 of compounding over a 20-year period.

4           And CAP also supports the development of a  
5 retirement receipt or an annual disclosure of a  
6 retirement account's investment and administrative  
7 fees in dollar terms. In fact, the Department of  
8 Labor should consider adopting similar disclosures for  
9 all retirement accounts, not just those under the  
10 exemption.

11           Yet if the proposed rule focuses only on  
12 disclosure, as some have argued it should, it will  
13 have missed the point. Additional information can  
14 help savers and retirees make comparisons and identify  
15 where their hard-earned dollars are going, but when  
16 savers enter into a perceived relationship of trust  
17 they should not have to worry that their advisor is  
18 serving his or her own financial needs instead of  
19 their needs. That's why it is essential for the  
20 Department of Labor to create a legal obligation for  
21 all financial professionals in the retirement  
22 marketplace to act in their clients' best interest.

23           Thank you for the opportunity to testify  
24 today, and I look forward to our continued dialogue on  
25 this rule.

1 MR. HAUSER: Thank you.

2 MR. LARSON: Thank you. Good afternoon.  
3 I'm Jean-David Larson, Director of Regulatory and  
4 Strategic Initiatives at Russell Investments. Thank  
5 you for affording me the opportunity to present my  
6 views here today.

7 Russell Investments is a global financial  
8 services firm that provides consulting, asset  
9 management, manager research, trading implementation  
10 and index services. Our entire business is built to  
11 serve the needs of our clients, who are the  
12 organizations and people that drive our economy and  
13 are the backbone to retirement savings.

14 Russell serves our clients exclusively on an  
15 agency basis and typically in a fiduciary status,  
16 putting our clients' interests first. Our long and  
17 deep heritage in financial services, combined with our  
18 breadth of experience across various client segments  
19 in global markets, provides us with a perspective on  
20 clients, regulators, markets, investment products and  
21 investment solutions that I hope will inform the views  
22 I share with you here today.

23 Retirement savings is a social and national  
24 imperative. The positive externalities of adequate  
25 retirement savings are immense. In the U.S., total

1 household savings is under 4 percent and projected to  
2 fall further, particularly due to low saving rates  
3 among young workers. In 2012, the average U.S. worker  
4 spent more on coffee than they invested for  
5 retirement. We are a consumer culture.

6 The single most important action that we can  
7 do to improve retirement security is to save instead  
8 of spend. If we do not reverse this trend,  
9 undersaving will place our economy and the majority of  
10 workers' standard of living in jeopardy both in terms  
11 of long-term growth and our resiliency to economic or  
12 personal shocks.

13 Now turning to my recommendations, first  
14 I'll make a suggestion about how to avoid disruption  
15 in the institutional market as the ABA did, then  
16 suggest two modifications aimed at the retail market  
17 and lastly provide recommendations related to the  
18 suggested low-cost safe harbor.

19 The primary focus of the Department's  
20 analysis is on the retail segment of the market, not  
21 institutional. We support this focus, given that the  
22 institutional market benefits from existing safeguards  
23 and generally functions well. Sweeping changes to  
24 what has evolved over ERISA's 41-year tenure would be  
25 very disruptive and for no clear benefit.

1           The Department appears to acknowledge this  
2 by proposing a seller's carve-out for plans greater  
3 than a hundred participants. However, I believe  
4 there's a more straightforward approach. My first  
5 recommendation is that you modify the proposed rule  
6 such that by definition it only applies to persons  
7 directly advising individual accounts or small plans.

8       This would avoid introducing unnecessary ambiguity,  
9 risk and cost on the institutional market.

10           Now to turn to retail. In the retail  
11 market, there is certainly some degree of confusion as  
12 to when or whether a financial professional is acting  
13 in a fiduciary capacity. Individuals should be  
14 afforded protections that enable them to clearly  
15 differentiate between providers and the levels of  
16 services and protections they are afforded.  
17 Individuals should be able to rely on their agent to  
18 act with loyalty, care and prudence.

19           The Department recognized that the retail  
20 market is not homogenous. Some investors are highly  
21 sophisticated, often using their financial  
22 professional for execution only or as a second opinion  
23 immediately prior to executing investments that they  
24 already had in mind. Therefore, my second  
25 recommendation is for the creation of a sophisticated

1 investor exemption.

2 In doing this, the Department would be  
3 emulating a well-established approach under securities  
4 laws of providing relief to accredited investors or  
5 qualified clients. This carve-out would enable firms  
6 to adapt their compliance programs offering and sales  
7 efforts with less disruption than what has been  
8 proposed.

9 My third recommendation is that the  
10 Department accelerate work to enable state and open  
11 multiple employer plans, MEPs, to move forward. This  
12 will significantly benefit small savers, which is a  
13 segment of the market that deserves the most attention  
14 and is the most at risk of being further underserved.

15 While this segment could be helped through technology  
16 or other means, our collective efforts would fall  
17 short of truly helping them improve their financial  
18 security if we commoditize them in the same way that  
19 the advice to them is increasingly proposed to be  
20 commoditized.

21 As the Department notes in its analysis,  
22 many retirement accounts are either in an employer  
23 sponsored plan or the result of a rollover from an  
24 employer plan. Employers provide these plans as a  
25 competitive means of retracting and retaining

1 employees. Larger employers have the expertise  
2 in-house to set up such a plan or, in any event, are  
3 able to afford the cost of outsourcing that work.  
4 Smaller plans do not have these scale advantages.

5 A plan is a costly, complex and burdensome  
6 undertaking. As a result, about half the small U.S.  
7 employers do not offer retirement plans today. That  
8 number increases to 75 percent for employers with  
9 fewer than 25 employees. While these companies are  
10 extremely diverse, the considerations they must weigh  
11 in making fiduciary decisions are largely the same.  
12 There are significant advantages to be gained if these  
13 small plans can leverage best in class design and  
14 collectively pool their assets. The Department should  
15 facilitate the formation and servicing of all these  
16 plans.

17 At the direction of the President, the  
18 Department will be providing guidance to the U.S.  
19 states regarding the status of state sponsored MEPS  
20 under ERISA. This will clear the path for states to  
21 enact legislation and begin offering these much needed  
22 solutions to small plans within their states. We  
23 eagerly await that guidance.

24 My fourth recommendation is to piggyback off  
25 those efforts and facilitate the emergence of private

1 or open MEPs. To the extent that changes in the  
2 proposed rules may cause small savers to be  
3 underserved, allowing these plans to organize under an  
4 MEP structure would not only mitigate that impact; it  
5 would also vastly improve their ability to deliver  
6 higher quality, lower cost solutions to their  
7 employees. It would further increase the propensity  
8 of small employers to set up retirement plans, which  
9 by itself would be a significant contribution to  
10 improving national retirement security.

11 While the acceleration of state MEPs will be  
12 significant, state MEPs will have their limitations  
13 and will likely, and rightfully so, be focused on  
14 lower income participants in their states. Open MEPs  
15 would provide an important bridge between advisor  
16 advised plans and state advised plans.

17 I understand the Department's reservations  
18 about for-profits establishing and running MEPs.  
19 However, with the proper controls and safeguards a  
20 competitive private sector marketplace can create  
21 innovative, efficient and prudent solutions that can  
22 help address the needs of this vastly underserved  
23 marketplace.

24 The last item I will address today is the  
25 low-cost safe harbor exemption. I recommend that the

1 Department not advance this proposed exemption and  
2 instead reformulate an exemption along the lines of a  
3 QDIA exemption. This exemption would only be  
4 available for models and products that meet certain  
5 criteria, as is the case today. This would  
6 disproportionately benefit small savers and be a  
7 highly desirable solution.

8 In designing portfolios, one should start  
9 with investment beliefs about sources of return, how  
10 they'll perform and over what time horizons, then  
11 construct the portfolio using all three sources of  
12 exposure to ensure that a portfolio is designed to fit  
13 a client's needs. Lastly, dynamically monitor and  
14 manage the exposures.

15 The three sources of return that we employ  
16 in a total portfolio management approach are index  
17 replicating strategies to capture a market segment's  
18 overall opportunity set, smart beta strategies to  
19 express active factor positions in the short or long  
20 term and active strategies where we believe that  
21 active management can add value from security or  
22 market selection. This is particularly important  
23 because you can mix active strategies together to  
24 deliver higher returns for the same risk level or,  
25 conversely, take less risk to achieve the same return.

1                   Clearly there are plenty of passive  
2 products. However, there are no truly passive  
3 investors since every decision is inherently an active  
4 one, including at the time of its creation decisions  
5 about which criteria to include in an index's  
6 composition.

7                   There are also situations where passive  
8 management may not be in the best interest of clients.

9       For example, passive strategies are not clearly  
10 defined. Russell calculates over 700,000 benchmarks  
11 daily. Any one of these could be a passive strategy.

12       Passive strategies still require active intervention  
13 for allocation among passive choices.

14                  They also may overlook significant sources  
15 of investment returns where smart beta or active  
16 management strategies have a better chance to  
17 outperform. Passive strategies may severely restrict  
18 the choice of indexes and loosely replicate the asset  
19 class, and, lastly, passive strategies may be  
20 inefficiently constructed. This is particularly true  
21 in fixed income.

22                  Investment solutions should be designed to  
23 seek the optimal risk/return tradeoff to help  
24 investors improve their financial security and should  
25 use the full spectrum of tools available without comps

1 (phonetic), not just costs in mind. Passive and smart  
2 beta are highly useful tools to be wielded in that  
3 process, but they are not a substitute for a well  
4 diversified and appropriately constructed and managed  
5 portfolio.

6 To limit one's investment universe to only  
7 one type of investment product could be a costly  
8 mistake over the long run. In its commentary the  
9 Department calls out passively managed target date  
10 funds as a potential solution. Passively managed  
11 target date funds are an oxymoron. Target date funds  
12 are portfolios that are designed and based on active  
13 investment beliefs and inputs about the strategies and  
14 about investors, particularly an investor's time  
15 horizon to retirement and risk appetite along that  
16 glide path.

17 These are highly dynamic strategies. The  
18 decision of how to allocate among these strategies and  
19 how to modify that over time inherently is an active  
20 decision. For these reasons, the Department should  
21 not seek to optimize cost and conflict mitigation at  
22 the expense of investment outcomes. This may invite a  
23 race to the bottom if the regulatory arbitrage is seen  
24 as significant, which it undoubtedly would be.

25 We have seen this play out in the DC space

1 all too often despite our best efforts to highlight  
2 the need for sponsors to follow a robust, prudent  
3 process through which process they decide the balance  
4 of risk, return and cost that is best suited for their  
5 needs, which invariably will include some, but not  
6 exclusively, passive strategies.

7           These suggestions are only a few of the many  
8 options available to the Department. Thank you again  
9 for the opportunity to share my views on this exciting  
10 and challenging new approach to improving our  
11 collective financial security. I look forward to your  
12 questions and the results of this collaborative  
13 process. If you have any questions after today,  
14 please feel free to contact me.

15           MR. HAUSER: Thank you.

16           MR. CANARY: Thank you. I'll start with a  
17 few questions, maybe the same question probably for  
18 Mr. Larson and Mr. Cleary at some level. I think  
19 you're both suggesting that we consider some sort of  
20 an institutional special carve-out provision, special  
21 treatment.

22           The rule as currently drafted requires that  
23 there be a recommendation directly to the plan, plan  
24 fiduciary, participant, beneficiary, IRA or IRA owner.

25           Am I correct in understanding that your concern is on

1 the reference to plan fiduciary there in terms of the  
2 institutional space because it would seem like if  
3 you're dealing with advice to an institutional  
4 investor you're not normally dealing with a plan  
5 unless you're treating an institutional investor as a  
6 large plan or the individual participant, the  
7 beneficiary or IRA? Is that the textual focus of your  
8 concern?

9 MR. LARSON: A little bit, but not really.

10 MR. CANARY: Okay.

11 MR. LARSON: The focus for my comment at  
12 least is that you've got exemptive release. You've  
13 got advisory opinions. You've got 41 years of ERISA  
14 history and experience that people live and breathe by  
15 every day on the plan side and on the institutional  
16 side. And as I said, it generally works really well  
17 where a named fiduciary or acting in a fiduciary  
18 capacity for our clients works really well.

19 Introducing ambiguity by having a new  
20 uniform standard, and I understand the appeal of a  
21 uniform standard. I just don't see the need for it.  
22 So I do think recognizing there are different markets,  
23 particularly the larger institutional market versus  
24 the retail and the smaller institutional market.

25 That's where my suggestion very basically

1 would be flip it on its head and rather than creating  
2 a carve-out limit the scope of the rule to those, the  
3 inverse of who you would have carved out, so the  
4 retail.

5 MR. CANARY: Okay. It may be more of sort  
6 of a drafters' question rather than a conceptual  
7 question.

8 MR. LARSON: Okay.

9 MR. CANARY: I was trying to focus on I  
10 think what you're saying is that if we looked at the  
11 definition itself to be investment advice the  
12 recommendation has to be directly provided to certain  
13 listed parties, and I would think that unless you're  
14 talking about a large plan where we have, as you  
15 pointed out, the seller's carve-out the term you're  
16 talking about as the plan fiduciary is where you're  
17 going to run into this institutional market tension,  
18 but maybe I'm missing it, and that may be more of a  
19 drafters' question.

20 MR. LARSON: Yes. From our experience, yes,  
21 that's primarily, but I guess I'm saying they can  
22 co-exist.

23 MR. CANARY: Okay.

24 MR. LARSON: The existing standards that  
25 have existed for institutional plans, the judicial

1 precedent, everything that's out there, I wouldn't  
2 want to see it all disrupted and create additional  
3 ambiguity trying to figure out how that now plays  
4 under a new standard with new rules because, as I  
5 said, I think it works and you've already got the  
6 safeguards and protections in place.

7 MR. CLEARY: I would just add a couple  
8 things. I hope they help answer your question.

9 First of all, it really touches on two  
10 concerns. The first is the definition of investment  
11 advice in the first place regardless of who the advice  
12 recipient is, but the second is even when that  
13 definition of recommendation and the other elements  
14 are appropriately defined, we still think there should  
15 be a different standard as in 2111(b) for  
16 institutional investors or other sophisticated  
17 investors for that matter.

18 MR. CANARY: Okay. So let me follow up on  
19 that for a second. How do you distinguish between an  
20 institutional investor versus other sophisticated  
21 investors because we have seen in the securities laws  
22 accredited investor test, and the dollar threshold  
23 there seems like it could actually capture a fair  
24 percentage of a rollover market where I think the  
25 investor might perceive themselves to be more of a

1 retail investor rather than a sophisticated investor  
2 if it's measured just based on the account size. What  
3 would your test be?

4 MR. CLEARY: I think we would suggest  
5 starting with the existing tests under the securities  
6 laws. That would certainly be the starting point.

7 MR. CANARY: I see.

8 MR. LARSON: I would agree with that. I'm  
9 not sure what fraction of the market that captures,  
10 but I think by and large if people -- and I'm not  
11 saying they're exactly the same, but an accredited  
12 investor, the idea, the policy is that they can bear  
13 the loss.

14 I'm not suggesting that you want people  
15 bearing the retirement loss, but I think there's a  
16 certain quantum of net worth or income at which point  
17 if someone wants to be able to opt out or have a  
18 different standard apply to their relationship that  
19 they are sophisticated enough to make those decisions  
20 eyes wide open.

21 I think as a general matter though, there  
22 should be a fiduciary and those should be exceptions.

23 My institutional comment was just that I think the  
24 two are very different, and particularly because of  
25 the history on the institutional side I think that's

1       why I would treat those very separately versus on the  
2       rest of the market, if you will. I think it's fine to  
3       have a uniform standard and then carve out as need be.

4               MR. CANARY: Okay.

5               MR. CLEARY: If I could just add one more  
6       thing?

7               MR. CANARY: Sure.

8               MR. CLEARY: As you mentioned, the seller's  
9       exemption is getting at this distinction between  
10      institutional and retail investors, but the seller's  
11      exemption as currently drafted, it's unclear how far  
12      that would go. The threshold is that it applies to  
13      sale, purchase, loan or bilateral contracts.

14              So we think that limitation, first of all,  
15      it's unclear what that means exactly, but it really  
16      should be in the context of any type of recommendation  
17      as under the FINRA rule, not just limited to a  
18      particular contract or something like that.

19              MR. CANARY: I appreciate that. So if it  
20      were phrased to say any advice would be closer to what  
21      you'd be thinking would be an appropriate scope for  
22      the seller's carve-out?

23              MR. CLEARY: Yes, similar to the concept  
24      under the FINRA rule that there's an express  
25      acknowledgement from the advice recipient that they're

1 making their own independent decisions.

2 MR. CANARY: So let's focus on a  
3 sophisticated investor element just a little bit. Do  
4 you have a preference or observations about the  
5 following two approaches to what I think you're  
6 suggesting?

7 One approach would be that the relationship  
8 would still be fiduciary in nature. It's that we  
9 wouldn't carve that relationship out and make the  
10 person not a fiduciary, but we would then deal with  
11 exemptions or maybe the exemption and the conditions  
12 of the exemption would be different based on some  
13 sophisticated investor threshold.

14 That would be one approach. The other  
15 approach would be to say well, there isn't a fiduciary  
16 relationship at all to begin with. Do you have a  
17 preference as to the approach?

18 MR. CLEARY: Well, I think both of those  
19 need to be addressed. I think the real problem with  
20 the second aspect of not being a fiduciary in the  
21 first place is that the proposal's definition is  
22 overbroad and it does capture or could capture  
23 discussions that again neither side is expecting would  
24 rise to that level.

25 So I think we need to get it right first in

1 terms of who is an investment advice fiduciary in the  
2 first place, so I think that's important regardless of  
3 the institutional retail distinction, and then  
4 secondly I think once you are a fiduciary, yes, there  
5 should be a carve-out for institutional investors even  
6 if you fit within that tailored --

7 MR. CANARY: Okay. Maybe I wasn't entirely  
8 clear. So putting the institutional aside for a  
9 minute, assume that from your perspective we have  
10 crafted a definition of investment advice that you  
11 think is appropriately scoped, but let's also assume  
12 that definition doesn't have a carve-out for  
13 sophisticated, distinguishing an institutional versus  
14 sophisticated here from the definition of fiduciary.

15 So let's assume that and say well, then the  
16 approach would be looking at the exemptions and saying  
17 well, if you're dealing with a sophisticated investor  
18 but you are a fiduciary, the conditions would be  
19 different versus saying let's assume again the same  
20 facts and we still have the sophisticated investor  
21 covered by the definition. You say we want them  
22 excluded from the definition.

23 MR. CLEARY: I think there should be the  
24 ability with both parties agreeing, the sophisticated  
25 investor and the advice provider, to make that

1 arrangement themselves and to agree on those  
2 parameters of the relationship on their own, yes.

3 MR. CANARY: Mr. Larson?

4 MR. LARSON: Yeah. What I would add is that  
5 I think I agree with the approach, which is that if  
6 everyone is a fiduciary and you appropriately define  
7 the scope of how you become a fiduciary to where  
8 certain -- like in the institutional market, execution  
9 only or other things where it's clearly not advice or  
10 it's at the direction of the client.

11 I think in those instances as long as advice  
12 and how you enter the realm of being a fiduciary, as  
13 long as that's scoped appropriately I think then  
14 having relaxed conditions for sophisticated clients  
15 within the exemption makes sense so perhaps they're  
16 able to invest in different assets than would  
17 otherwise be the default, I think those would make a  
18 lot of sense.

19 In terms of excluding altogether, I'd have  
20 to think about that a little bit more because I  
21 understand there's a policy objective for not doing  
22 that in the current, you know, ERISA market with large  
23 plans because there's beneficiaries. There's a lot of  
24 stakeholders.

25 With an individual it's an individual, so I

1 think the policy argument of the extent to which  
2 there's I guess a government or social interest there  
3 is one, but to what extent would an individual  
4 interest and right potentially be able to supersede  
5 that, which is very different than in the current  
6 institutional market whereas, as I said, there's a  
7 very different social interest and thousands of  
8 beneficiaries depending on that, so not being able to  
9 waive that makes sense there.

10 MR. VALENTI: Two things I would add on that  
11 point.

12 MR. CANARY: Sure.

13 MR. VALENTI: One is I understand the  
14 principle of separating out sophisticated investors.  
15 I would caution that it should not be based solely on  
16 an income or asset threshold, recognizing that many  
17 families nearing retirement may meet that criterion  
18 alone.

19 The other is to consider the taxpayer  
20 interest in the over \$150 billion in tax expenditures  
21 for retirement security under ERISA and that there is  
22 a taxpayer interest in making sure that these savings  
23 are sound as opposed to an individual's personal  
24 investments outside of the ERISA framework.

25 MR. CANARY: All right. Thank you. Let me

1 follow up with you on a different subject. I think  
2 you have echoed something we've heard from other  
3 witnesses about concern with the mandatory arbitration  
4 provision that is in the best interest contract  
5 exemption, and some people have sort of elaborated on  
6 the reason why they have that concern. Could you give  
7 us a little bit more of your thoughts on that?

8 MR. VALENTI: It's along the lines with what  
9 you've heard from previous witnesses. We believe the  
10 current arbitration provision is clearly a compromise,  
11 and as we've seen and as the Consumer Financial  
12 Protection Bureau has seen across a wide range of  
13 financial products, consumers don't understand  
14 mandatory arbitration clauses. They're not aware that  
15 they are waiving important rights, and they often  
16 don't have a choice in the matter.

17 A good example, looking at the credit card  
18 market nearly all credit card providers have some form  
19 of mandatory arbitration clause. It's not a case  
20 where they're able to shop around and find a provider  
21 that is able to serve them adequately.

22 Conversely, what the Consumer Financial  
23 Protection Bureau found in its review of arbitration  
24 agreements, again looking at the credit card market,  
25 which is perhaps a little bit different than

1 retirement security, the issuers with arbitration  
2 clauses and the issuers without them did not have  
3 statistically significant differences in fees, so it  
4 was not a scenario in which the presence of  
5 arbitration actually resulted in lower fees for  
6 consumers.

7 MR. CANARY: Thank you. One more. I think  
8 your testimony also raised the coverage of HSAs under  
9 the rule, and I think you were suggesting that  
10 covering HSAs is appropriate. Other witnesses have  
11 suggested that the HSA account balances are lower,  
12 that they're invested more in bank investment products  
13 that may not present the same types of investment risk  
14 as other retirement investors. Can you speak to those  
15 observations?

16 MR. VALENTI: The issue that I would be  
17 concerned about in this environment is the sort of  
18 regulatory Whack-A-Mole problem in that you address  
19 concerns in one portion of the financial services  
20 industry or one type of product and as a result  
21 advisors are looking to direct their clients toward  
22 other products. HSAs are one example.

23 I would think a more serious example might  
24 be 529 plans; that there is fairly significant debate  
25 even among financial experts about saving for college

1 versus saving for retirement. Clearly there are  
2 different structures in 529s, and I would not want to  
3 see overconcentration in 529 plans as opposed to  
4 401(k)s and IRAs as a result of prohibitions on  
5 conflicted advice.

6 MR. CANARY: Thank you.

7 MR. HAUSER: Mr. Valenti (sic), in one of  
8 your answers to a question from Joe Canary you said  
9 that under our proposal you could have a circumstance  
10 where neither party to the communication expected a  
11 fiduciary relationship, but nevertheless we imposed  
12 one.

13 I have the opposite concern, which is that  
14 under your mutual agreement proposal you can have a  
15 circumstance where first off the customer reasonably  
16 thinks he's getting fiduciary advice, and nevertheless  
17 by virtue of a disclaimer and a contract that the  
18 customer likely doesn't understand the significance of  
19 they could be out of luck as far as holding your  
20 advisor to a fiduciary status.

21 And I'm equally concerned that under a  
22 mutual agreement kind of test you could actually have  
23 a circumstance where both parties really thought that  
24 this was a relationship of reliance, but again by  
25 virtue of a contractual disclaimer, you know, there's

1 no longer fiduciary status. Although our guidance is  
2 provided one-to-one, you know, on a professional  
3 basis, it is not to be relied upon as a primary basis  
4 for your investment decision making or your tax  
5 planning.

6 So can you reassure me on why your proposal  
7 wouldn't result in essentially defeating the  
8 legitimate expectations of retirement investors to  
9 best interest conduct?

10 MR. CLEARY: I guess a couple thoughts on  
11 that. First of all, in the institutional marketplace  
12 I think that's much less of a concern. As mentioned  
13 earlier, these are plan fiduciaries who have their own  
14 independent duty of investigation and prudence, so I  
15 think that is less of a concern. That confusion, in  
16 my experience at Northern Trust, really doesn't exist  
17 at the institutional level, certainly not with our  
18 types of large clients.

19 At the retail level I think that the easiest  
20 solution to that type of confusion is a prominent and  
21 clear disclosure up front that the advisor is not  
22 intending to offer investment advice. I also think  
23 that the limitations on the content of what would be  
24 outside the fiduciary context would be helpful along  
25 the lines of the FINRA guidance where there are

1 specific examples of asset allocation models, general  
2 investment advice and the like and also more generally  
3 directed communications that do not constitute a  
4 recommendation. I think that type of guidance could  
5 help put some parameters around that along with  
6 the --

7 MR. HAUSER: So, you know, when you give  
8 that disclosure the way you're thinking of it could  
9 the person nevertheless call themselves an advisor in  
10 their interactions with the customer, but use that  
11 disclaimer?

12 MR. CLEARY: My personal view on that would  
13 be no.

14 MR. HAUSER: And could the advertising for  
15 the institution say that we adhere to a best interest  
16 standard? Because that's been a theme of virtually  
17 every comment that we've received. We adhere to a  
18 best interest standard. We're, you know, interested  
19 in putting the investor in the right place. Could  
20 they do that and then give somebody a disclaimer, you  
21 know, even at the top of the documents that tells them  
22 but I'm not a fiduciary?

23 MR. CLEARY: I think again that you're  
24 correct. I agree. A balance needs to be struck  
25 there, and I do think regardless of the disclaimer

1       there could be some conduct that would cross that line  
2       and a disclaimer -- it would have to be the  
3       combination of staying within certain parameters and  
4       an appropriate disclosure.

5               MR. HAUSER:  And to the extent we relied on  
6       a disclaimer at all, what does that disclaimer  
7       communicate to a customer?  I mean, the fiduciary  
8       concept is a legal concept and it has certain  
9       consequences in terms of what the scope of the duties  
10      are, what the remedies are.

11              By saying I'm not acting as a fiduciary do  
12      you think that you're conveying to the customer and  
13      therefore here's the rights, remedies and  
14      responsibilities that go with that or disclaim from  
15      that?  It seems like an awful lot to ask of a simple  
16      disclosure.

17              MR. CLEARY:  Well, I guess what I would say,  
18      yes, a statement by itself, this is not fiduciary  
19      investment advice, I agree that for many advice  
20      recipients they wouldn't understand what that meant.

21              I would say the ABA and the banks would be  
22      happy to work with the Department on specific language  
23      for that type of a disclosure, but I think it could be  
24      done in a way that would be understandable.  Just as  
25      disclosure are used in the regulation for other

1 purposes, I think appropriate wording in a disclosure  
2 could be understandable to --

3 MR. HAUSER: But mightn't a more simple  
4 approach and one that would lend itself to less abuse  
5 be just to use essentially an objective sort of test  
6 along the lines of the FINRA standard, whether a  
7 reasonable person in light of these facts and  
8 circumstances in a particular context of the  
9 communication would view it as a suggestion to make a  
10 particular investment or pursue a particular  
11 investment strategy? I mean, that seems to me that  
12 that gets rid of all these problems.

13 MR. CLEARY: I guess a couple things. Yes,  
14 and I mentioned that earlier. I think if the scope of  
15 fiduciary investment advice is properly defined in the  
16 first place such a standard would make sense.

17 A couple comments on that. First of all, as  
18 I mentioned, the FINRA guidance has very useful  
19 examples of both sides. Here's a list of  
20 conversations or communications that would not be a  
21 recommendation and here's ones that would be, along  
22 with the carve-outs under 2111(b).

23 I think if that type of distinction were  
24 more clear and the line were brighter between a  
25 suggestion, a specifically directed suggestion, I

1 think what an objective person would consider a  
2 suggestion is too vague.

3 MR. LARSON: What I would add, and I take it  
4 from everything I've read and heard, is that you're  
5 clearly looking at changing how guidance and advice  
6 and information is scoped in the advisory standard.

7 One thing I'll say is, I mean, that's a  
8 hugely important and valuable distinction to make  
9 because I can't underscore enough the importance of  
10 allowing whether it's institutional retail or others  
11 to provide marketing and educational information. I  
12 mean, just getting people into the retirement  
13 ecosystem is such a huge benefit to our national  
14 retirement crisis. So that's the first step is we've  
15 got to get people into the ecosystem.

16 And then to your point in terms of what is  
17 it that they're receiving, what's the advice they're  
18 receiving, so first don't deter that point, like  
19 promote it as much as we can. Second is in terms of  
20 the advice that they're receiving, I agree objective  
21 standards make sense, and when you delineate between  
22 what marketing education is and advice that should be  
23 clear.

24 Disclosures, disclaimers, they don't work  
25 for investors. Most people, once they have their

1 expectations set of what they're getting and what  
2 they're doing that's the framework in which they  
3 operate. I think looking at the review, the output  
4 from the RDR analysis that came out of the U.K., the  
5 same thing.

6 I mean, one of the things that they said,  
7 which I thought was very interesting, was that there  
8 was a lot of confusion around cost even though there's  
9 all these disclosures around cost. And one of the  
10 things I thought was interesting, if you look at that  
11 and you also look at well, what did most clients who  
12 were in an advised relationship, how did they rank  
13 cost? Very lowly.

14 So when you ask them how do you pay your  
15 advisor, how does this work, they don't really know  
16 even though there's disclosure. And I think the  
17 reason, my suspicion about the reason is because it's  
18 not important to them. They've already decided that  
19 they want to work with that person. They believe, you  
20 know, trust is a high factor of why they continue  
21 working with that person. Cost is way down the list.

22 If you look at the person who's skeptical  
23 and maybe doesn't want to be in an advised  
24 relationship and is doing it themselves, cost goes up,  
25 but even not that high still so I think even for them,

1 you know, how important is the disclosure around cost?

2 I think it's moderately important, but they're coming  
3 at it from a different frame of mind.

4 So that's what I'd say is the frame of mind  
5 is one of the most important things. When people go  
6 into a relationship expecting a fiduciary level of  
7 service whatever else you put in writing is often  
8 going to get overlooked. It's still important and it  
9 needs to be simple and straightforward.

10 I think one of the most important pieces of  
11 advice that can be given to or reporting that can be  
12 given to an investor is how are they tracking relative  
13 to their funding goals and relative to their  
14 retirement goals. Whether you're making more than a  
15 benchmark, less than a benchmark, whatever it is, I  
16 think the gentleman mentioned earlier and we've done  
17 these calculations.

18 I mean, people lose money not because of how  
19 they're allocated as much as anything. I mean, that's  
20 a huge, important -- I don't want to downplay that.  
21 It's important, but it's the decisions they make along  
22 the way, and those decisions can erode any upside  
23 opportunity they otherwise would have gained.

24 So I think those are some of the things that  
25 I think are really important. From what it sounds

1 like you're on the right track and we'd support where  
2 you're headed, but with some of those cautions I guess  
3 peppered in there.

4 MR. HAUSER: Thank you.

5 MR. VALENTI: I would note that many  
6 disclosures are not effective. This is clear in  
7 retirement. This is clear across financial products.  
8 When they are effective they are very clear. They  
9 are very targeted. They have benchmarks.

10 One suggestion that I would add to the  
11 disclosures under the best interest contract exemption  
12 is what we call a 20/20 disclosure so that you  
13 illustrate the effects of fees compounded over 20  
14 years on a \$20,000 investment and you have a very  
15 simple, one line benchmark that you would be able to  
16 use to compare across different options.

17 I would say that costs are often not  
18 noticeable because they are hidden. Even when they  
19 are disclosed, the disclosures tend to be long or  
20 unclear or unworkable or they're not all inclusive.  
21 You have up front costs or others that are not  
22 included.

23 To the extent that you are able to shine a  
24 light on both the direct costs and the hidden costs,  
25 including both investment management fees and

1 administrative fees, particularly in simple dollar  
2 terms, you are able to educate investors, and as  
3 Morningstar and other firms have found in their  
4 research low-cost funds have often outperformed  
5 high-cost funds, so cost is a significant  
6 consideration for consumers even if they're not aware  
7 of it at the time.

8 MR. HAUSER: Thank you.

9 MR. LARSON: May I add something to that?

10 MR. HAUSER: Sure.

11 MR. LARSON: So I think two things that I  
12 wouldn't want to become a guidepost for rulemaking and  
13 that's conflicts and fees. Conflicts are not a bad  
14 thing. Conflicts are fine. If you're doing your job,  
15 you're going to run into conflicts all the time. The  
16 question is how do you manage those and how do you  
17 mitigate those?

18 So I think we want to make sure we always  
19 stay focused on first and foremost are you doing the  
20 best thing you can for your client as a fiduciary and  
21 then, if so, as conflicts present themselves how did  
22 you manage those in the best interest of the client?

23 I think the same thing with fees. I would  
24 be concerned among other reasons that if we overly  
25 focus on fees you're focusing on the wrong thing.

1 You're not focusing on the objective, which is are you  
2 getting into saving? Are you investing? How much are  
3 you investing? How is that investment aligned with  
4 your overall goals of income or wealth accumulation  
5 and making sure that you're designing your program to  
6 reach those goals?

7 Cost is definitely a factor, but it is a  
8 smaller factor. I mean, we've talked about timing  
9 decisions and other decisions. Those are all costs  
10 that don't get reflected in, you know, your net return  
11 in terms of how did you perform against a benchmark or  
12 how did this or that do.

13 So the most important thing, and I think  
14 this is where targeted funds have done a tremendous  
15 service for the industry, is helping clients and  
16 simplifying the decisions that they need to make about  
17 how to reach their retirement goals because it's  
18 taking a well-diversified approach that's combining  
19 different strategies that I've mentioned and allowing  
20 investors to access that in a cost effective,  
21 simplified way.

22 Again, I think we just don't want to overly  
23 focus on fees because I think there's a risk that we  
24 will steer individuals in the wrong direction versus  
25 focusing on the retirement goal.

1           MR. HAUSER: Thank you. And as to your  
2 first point about conflicts, I mean, this regulation  
3 obviously is very much about mitigating conflict. It  
4 is not, however, about eradicating them. We're under  
5 no illusion in that regard.

6           And then just one other thing I'd say and  
7 maybe just invite comments is you said you thought we  
8 were -- I don't want to put words in your mouth, but  
9 on the right track as far as this line, what I'm  
10 thinking in terms of education versus advice and what  
11 counts as fiduciary and what doesn't count as  
12 fiduciary, but that is what I described as what would  
13 count as a fiduciary recommendation is what we tried  
14 to write in here. I mean, that objective test is what  
15 was intended.

16           In the American Bankers Association comment  
17 letter there are a number of places where you say  
18 things like any nugget of information about investment  
19 would be treated as a fiduciary. Clearly not so.  
20 There needs to be a recommendation. We reference  
21 specifically the FINRA standard, the call to action  
22 sort of concept and our education provisions, which is  
23 probably if you look at this the longest segment of  
24 the rule.

25           They specifically note all the different

1 kinds of communications you could have that wouldn't  
2 be treated as fiduciary in nature, including a  
3 detailed description of product attributes, you know,  
4 historical performance, benchmarks, all the rest of  
5 it. It's just a question of whether you cross that  
6 line and essentially fail that objective test. So if  
7 there's something more you think we need to say in  
8 that space to make that clearer that would certainly  
9 be helpful.

10 MR. CLEARY: Well again, I guess a couple of  
11 comments on that. First, I do think some examples  
12 that were specific to the retirement investor context  
13 would be very helpful in that regard so that we can  
14 see examples of what's on which side of that line.

15 But, secondly, the carve-out, particularly  
16 the ones for asset allocation models, investment  
17 education, the way they seem to draw the line at not  
18 being able to mention a specific investment  
19 alternative under the plan, again that creates  
20 ambiguity about whether you're giving investment  
21 advice in the first place. We would like to think  
22 well, if there's no recommendation in the first place  
23 you don't even get to that.

24 MR. HAUSER: Well, that's correct. If  
25 there's no recommendation you don't get to it and so

1 maybe carve-out was the wrong word to use. But can I  
2 just say --

3 MR. CLEARY: Sure.

4 MR. HAUSER: -- on the allocation issue a  
5 number of people have said at least -- you know, even  
6 supporters of the rule have said in that context maybe  
7 you should in the plan context where the investment  
8 lineup is overseen by a separate fiduciary you should  
9 go ahead and permit them to populate that asset  
10 allocation model as long as they populate it with all  
11 of the designated options under the plan and also  
12 maybe as long as they don't have a financial interest  
13 in this fund option versus that option when they do  
14 it. Would that answer your concern on that score?

15 MR. CLEARY: That would certainly help, but  
16 again sort of the scenario we're concerned about is  
17 you've got a participant call center and a participant  
18 calls in and they want general education about asset  
19 classes, but then they ask a question. Well, which  
20 investment options under this plan are part of that  
21 asset class?

22 And if you're really careful you could  
23 answer that question factually, but my concern is that  
24 the investor will say well, they suggested that I go  
25 into that fund, and you can get into a real debate

1 about objectively would that have been a suggestion or  
2 not, and I just think that shouldn't even be.

3 It should be more clear that answering a  
4 question like that is outside the scope, even if it  
5 involves a specific option under the plan. But  
6 certainly where the person answering the question,  
7 there isn't a conflict there in the first place, that  
8 clearly should be carved out even if it does fall in a  
9 suggestion.

10 MR. HAUSER: Okay. And I will let you have  
11 the last word on that because we're out of time.  
12 Thank you very much.

13 (Pause.)

14 MR. CANARY: All right. So if you all are  
15 ready, Mr. Hauser had something else he had to  
16 accomplish, so he's risked putting me sort of in  
17 charge. We'll see how that goes.

18 But I wanted to introduce Bill Taylor. He's  
19 with our Solicitor's Office, Plans Benefits Security  
20 Division. He's sitting in in place of Mr. Hauser on  
21 the panel. So with that, please begin.

22 MS. SUPOVITZ: Okay. I would say what does  
23 Mr. Hauser possibly have to accomplish? Thank you for  
24 the opportunity to testify today. My name is Marcy  
25 Supovitz, and I'm a principal with Boulay, Donnelly &

1 Supovitz Consulting Group in Worcester, Massachusetts.

2 We provide consulting, administrative, actuarial and  
3 investment advisory services to employer sponsored  
4 retirement plans.

5 I'm speaking today on behalf of the American  
6 Retirement Association and its four member  
7 organizations, the American Society of Pension  
8 Professionals and Actuaries or ASPA, the ASPA College  
9 of Pension Actuaries, the National Association of Plan  
10 Advisors and the National Tax Deferred Savings  
11 Association. I currently serve as president elect of  
12 the American Retirement Association and was a past  
13 president of the National Association of Plan  
14 Advisors.

15 So our members are in the business of  
16 serving employer-sponsored retirement plans and long  
17 accustomed to operating under ERISA fiduciary  
18 standards, as well as unconflicted compensation  
19 structures. These are concepts that are very much a  
20 part of our fabric, so I think that it goes without  
21 saying that we strongly support the DOL's efforts to  
22 impose a best interest standard for retirement  
23 savings.

24 But we do see some disconnects in the  
25 proposed rule that we think would undermine our

1 ability to serve clients in the best way possible.

2 It's our hope and actually our very strong belief that  
3 we can get to a rule that's more workable and more  
4 beneficial for the people that it's designed to help.

5 So to that end my testimony today will focus on five  
6 key concerns, and the first relates to rollovers in  
7 connection with the workplace retirement plans that we  
8 serve.

9 Our concern is that the proposed rule will  
10 discourage plan advisors from working with  
11 participants on rollovers even in situations where  
12 there's level compensation on both sides of the  
13 transaction -- level, unconflicted compensation -- and  
14 that's because a rollover from an employer-sponsored  
15 plan to an IRA will likely increase the advisor's  
16 compensation, assuming the participant wants  
17 personalized, holistic financial advisory services for  
18 the IRA.

19 So we know that any increase in compensation  
20 here would be a prohibited transaction unless an  
21 exemption applies and, as I'll talk about in a minute,  
22 it isn't clear that any such exemption exists. So  
23 first let me give you a specific example of why this  
24 rollover concern is very important. Suppose we have a  
25 401(k) participant. I'm going to call him Joe has

1       been working with Plan Advisor A for over 10 years  
2       and, like many working Americans, the only advisor Joe  
3       works with is Advisor A through his 401(k) plan at  
4       work.

5               So now Joe is about to retire, and the plan  
6       doesn't offer systematic withdrawals, which is very,  
7       very common. In fact, my understanding is that it  
8       applies to your own TSP plan for government employees.

9       So the plan doesn't offer systematic withdrawals, and  
10      as a result Joe wants to work with Advisor A on a  
11      rollover because he trusts her and because the plan  
12      doesn't give him an effective way to manage his money  
13      in retirement.

14             So the advisor, and I'm going to call her  
15      Sue, she operates as an ERISA fiduciary to the plan  
16      and she receives level compensation of 30 basis points  
17      for those services. She's now proposing level  
18      compensation of 75 basis points in the rollover IRA  
19      because Joe wants personalized financial services.  
20      Since both arrangements are conflict free there's no  
21      exemption required for Sue's work with the plan,  
22      there's no exemption required for Sue's work with the  
23      IRA, but an exemption is needed for the rollover  
24      transaction itself.

25             Now, it isn't clear that the best interest

1 contract exemption -- I'm going to call it the BICE.  
2 It isn't clear the BICE is available for rollover  
3 transactions to begin with, but even if it is it still  
4 wouldn't be available for this rollover transaction  
5 because it doesn't extend to discretionary investment  
6 management.

7           And moreover, the BICE is specifically  
8 designed, as you of course know, for differential  
9 compensation, and here we have a situation where  
10 compensation is level and investment neutral so it  
11 really doesn't make sense to impose all of the BICE  
12 requirements. That would discourage plan advisors.  
13 These are the advisors that have already been vetted  
14 by the plan sponsor, and it would discourage them from  
15 serving participants after retirement. I don't think  
16 that was the Department's intent.

17           So we believe a better solution would be to  
18 create a separate streamlined exemption that I'm going  
19 to refer to as the level-to-level compensation  
20 exemption, and I'm very pleased to say that this  
21 concept was supported by a group of Senate democrats  
22 who I believe sent you a letter. It probably came  
23 while you were all sitting here, but this was a group  
24 of Senate democrats who very much support this  
25 level-to-level compensation concept.

1           In order to use this new exemption, the  
2           advisor would have to meet some core conditions,  
3           including of course level compensation on both sides  
4           of the transaction, a written agreement between the  
5           advisor and the participant, a disclosure that  
6           includes a comparison of the advisor's compensation at  
7           the plan level and at the IRA level and then  
8           documentation outlining why the rollover transaction  
9           is in the best interest of the participant.

10           So I also want to point out that for  
11           purposes of this exemption we're talking about  
12           compensation that regardless of the investment  
13           selected there would be no change in the advisor's  
14           compensation, and even if the financial institution as  
15           a whole receives differential compensation, which is  
16           sometimes the case, there should be no incentive for  
17           the advisor's advice to be influenced by any  
18           compensation flowing to the financial institution, and  
19           that's consistent with the statutory exemption for  
20           eligible individual advice arrangements that we have  
21           today.

22           So I want to move on to our second concern,  
23           which relates to investment education, and I want to  
24           emphasize that my comments here relate solely to  
25           401(k) and workplace retirement plans, not to IRAs.

1 And I know that many of those testifying, as well as  
2 many of the comment letters, suggested that the  
3 proposed rule unnecessarily changes the framework of  
4 Interpretive Bulletin 96-1 by prohibiting reference to  
5 specific investment products, specifically in asset  
6 allocation models, and I also understand the  
7 Department's concern that identifying specific  
8 products could be advice disguised as education.

9 And you folks know this and you've mentioned  
10 it a few times. The issues and implications for  
11 workplace plans are really very different than for  
12 retail type accounts. The part that I haven't heard  
13 many people talk about is in the context of 401(k)  
14 plans often times the asset allocation models are  
15 designed by the fiduciaries of the plan, populated by  
16 specific investments in the plan and then presented by  
17 nonfiduciaries to educate participants.

18 So here the models become actually an  
19 investment option that they can elect, and it gives  
20 them a very simple way to do that. And we believe  
21 that as long as the models are populated by ERISA plan  
22 fiduciaries that have no financial incentive to choose  
23 one investment product over another that anybody  
24 should be able to present those models to participants  
25 without being treated as a fiduciary.

1           So in the interest of time I'm going to move  
2           on to our third concern, which relates to small  
3           business retirement plans, and I think we all know  
4           that small business owners are slow to embrace  
5           retirement plans and without an advisor's  
6           encouragement and assistance many of them wouldn't  
7           adopt a plan at all.

8           Now, I want to reiterate that we do support  
9           a best interest standard for all plans, all qualified  
10          retirement plans, but we do believe that the proposed  
11          rule puts impediments in the way of advisors who want  
12          to work with small businesses. Now, a lot of advisors  
13          who work with small businesses are reliant on the  
14          compensation models that would become available under  
15          the proposed rule, and the final rule should implement  
16          the best interest standard in a way that doesn't  
17          discourage them from working in that market. So to  
18          that end we suggest expanding the definition of  
19          retirement investor in advice to include small  
20          participant directed plans.

21          And since my time is up I'll just mention  
22          that a final but very important concern relates to the  
23          transition period. I'm sure you've heard this over  
24          and over. We are suggesting a minimum two-year  
25          transition period.

1           So thank you. We appreciate the opportunity  
2 to work with the Department, and we'll take whatever  
3 questions you have.

4           MR. CANARY: Thank you.

5           MR. ROUSE: Good afternoon and thank you for  
6 the opportunity to testify today on behalf of the  
7 SPARK Institution. SPARK is a nonprofit trade  
8 association representing a broad cross-section of  
9 retirement plan service providers and investment  
10 managers. Our members include banks, mutual fund  
11 companies, insurance companies, third party  
12 administrators, trade clearing firms and benefit  
13 consultants.

14           My name is Tim Rouse. I joined SPARK as the  
15 executive director in June, and prior to joining this  
16 fantastic organization I spent 30 years working with  
17 many of the firms who have sent you comment letters on  
18 the proposal. I couldn't have joined SPARK at a more  
19 critical time in our industry, and here with me is  
20 Mike Hadley, SPARK's outside counsel, who may assist  
21 me with some of the questions today.

22           The proposal and the related exemptions will  
23 affect virtually every aspect of SPARK members'  
24 retirement business. Our comment letter and my  
25 testimony focus primarily on how the proposal will

1 affect our members' ability to continue providing  
2 their invaluable education, guidance and services to  
3 both plan sponsors and their participants.

4 Due to the constraints I will not address  
5 every point of our comment letter today, but instead  
6 let me focus on three principles contained in all of  
7 our comments. First, fiduciary standards should apply  
8 only where there is a clear and reasonable expectation  
9 that fiduciary advice is being provided.

10 Second, a service provider and a plan  
11 sponsor should be permitted to agree upon and define  
12 in writing the service provider's role, whether a  
13 fiduciary relationship exists and the scope of the  
14 fiduciary relationship, if any.

15 Third, the line between fiduciary and  
16 nonfiduciary services must be clear and must not  
17 prevent the service provider from furnishing valuable  
18 information and guidance to plan sponsors and  
19 participants.

20 I will begin my comments by addressing the  
21 proposal's definition of fiduciary itself and offer  
22 suggestions to make the definition more effective.  
23 Then I will offer comments on the education, selling  
24 and platform carve-outs. Third, I will briefly  
25 address the best interest contract exemption, and then

1 I'll close with our concerns, like Marcy's, on the  
2 need for time with regard to the implementation of the  
3 rules.

4 A fundamental concern that SPARK members  
5 have with the proposal is that it calls into question  
6 a variety of communications that service providers  
7 have with participants that cannot reasonably be  
8 viewed as investment advice. Participants generally  
9 receive two kinds of communication from plan sponsors  
10 and their service providers. First, generic plan  
11 related information, much of which is required by law.

12 For example, this would include the summary plan  
13 description.

14 Plan related information is important, but  
15 it is not enough to motivate participants to prepare  
16 for retirement. All other communications, some of  
17 which is clearly education under the current law, are  
18 intended to provide guidance. Because of the  
19 responsibility placed on participants for their own  
20 retirement and 401(k) type of plan, participants must  
21 be educated and motivated.

22 Many service provider communications  
23 therefore are suggestions that participants either  
24 take an action, like diversifying their account, or  
25 not take an action, like avoiding taking a loan or

1 early distribution. Our comment letter makes a number  
2 of suggestions to help the proposal's definition of  
3 fiduciary investment advice better focus on those  
4 recommendations that a reasonable person would expect  
5 to be fiduciary in nature.

6 First, we recommend that the Department  
7 incorporate a reasonableness requirement. For  
8 example, advice should only be fiduciary in nature  
9 when it is provided under circumstances that a  
10 reasonable person would understand to be  
11 individualized advice that may be relied upon for  
12 making investment or investment management decisions.

13 Second, including our recommendations that  
14 are specifically directed to an advice recipient as  
15 investment advice could be interpreted too broadly and  
16 call into question very standard forms of  
17 communication from service providers. For example,  
18 imagine that as part of a diversification campaign a  
19 service provider sends a communication to all  
20 participants that have the participant's name at the  
21 top of the letter.

22 This letter provides a list of all the  
23 target date funds options available to the participant  
24 and explains why target date funds may be an  
25 appropriate way for a participant to diversify their

1 account. This communication appears specifically  
2 directed to a participant, but no one would think of  
3 that as fiduciary investment advice.

4 Third, we ask the Department to confirm the  
5 phrase agreement, arrangement or understanding  
6 requires a meeting of the minds. A service provider  
7 that does not act in any way that would make it  
8 reasonable to conclude that an understanding exists  
9 should not be designated as a fiduciary simply because  
10 a participant unilaterally decided that there was an  
11 understanding.

12 Fourth, the proposal should clarify so that  
13 it does not cover service provider responses to an RFP  
14 from a prospective customer. Similarly, it should not  
15 be a fiduciary investment advice to recommend another  
16 person to provide advice or investment management  
17 services unless the person making the recommendation  
18 was specifically engaged to make the recommendation  
19 for a fee. It is critical that the service provider  
20 can offer third party advice services as part of their  
21 overall offering without becoming a fiduciary.

22 Finally, we ask the Department to confirm  
23 longstanding guidance that a fiduciary may limit the  
24 scope and timeframe of the fiduciary's duties and  
25 obligations. We offer a number of suggestions for

1 clarification on this matter, and you'll find them on  
2 page 16 and 17 of our letter.

3 Let me move on to the carve-outs. Because  
4 the Department's proposed definition of fiduciary is  
5 so broad, the carve-outs in the proposal are  
6 tremendously important. We focused on three in our  
7 comment letter. Let me begin with education.

8 It is critical that the Department not limit  
9 the ability of our members to provide asset allocation  
10 education in reference to a specific investment  
11 selected and monitored by the fiduciary. Helping  
12 participants make smart decisions with the investments  
13 available in their plan is fundamental to the success  
14 of a 401(k) system, along with encouraging sufficient  
15 contribution, this really is our number one job.

16 It is also critical that distribution  
17 education be preserved. As we point out in our  
18 letter, our members are very concerned about having to  
19 distinguish between the provisions of information on,  
20 A, the advantages, disadvantages and risks of the  
21 distribution options available to the person and, B,  
22 the information on the appropriateness of such  
23 distributions. While the former fits within the  
24 carve-out, the latter does not, yet the difference  
25 between the two seem indistinguishable.

1                   Next, we believe the Department should  
2 extend the seller's carve-out to plans of all sizes.  
3 In the context of the seller's carve-out, the only  
4 question should be whether a fiduciary is  
5 knowledgeable enough to know the difference between  
6 someone who is selling a product and someone who is  
7 providing impartial investment advice. Owners of  
8 small businesses routinely deal in the marketplace  
9 with vendors of all kinds. Small business owners can  
10 make independent judgments of this nature, and they do  
11 this with all sorts of vendors.

12                   My final point on the carve-out is that the  
13 selection and monitoring carve-out should be clarified  
14 to allow service providers to continue to help plan  
15 fiduciaries and individuals parse through the  
16 thousands of investment alternatives available to  
17 them. The carve-outs should not be available only in  
18 connection with the platform and only when the advice  
19 recipient specifies the objective criteria to be used  
20 in selecting the investments.

21                   Instead, the carve-outs should be available  
22 if the service provider identifies investment is based  
23 on objective criteria, it is disclosed to the advice  
24 recipient. The selection and monitoring carve-outs  
25 should also allow service providers to furnish a

1 sample menu and provide mapping assistance if  
2 accompanied by appropriate disclosure.

3 Allow me to now briefly discuss the best  
4 interest contract exemption. Our comment letter lays  
5 out a number of specific concerns that SPARK members  
6 have with the exemption in the current form. I won't  
7 repeat those here, but I would make the point that an  
8 exemption is not a workable solution for plan services  
9 and should not be fiduciary in nature. It is not a  
10 fiduciary solution for ordinary call center  
11 interactions in ordinary participant communications.

12 The most effective way to enable providers  
13 to continue to provide their crucial services while  
14 still protecting plans and retirement savers will be  
15 to narrow the proposal's definition of what  
16 constitutes investment advice and better accommodate  
17 existing education tools within those proposed  
18 carve-outs.

19 Again, my final comments are on the proposed  
20 effective dates. The entire regulated community will  
21 need a substantial amount of time to implement these  
22 new rules. We urge the Department to consider 36  
23 months for compliance. An insufficient timeline would  
24 force providers to immediately halt longstanding  
25 services. The retirement industry has focused on this

1 fiduciary definition for over 40 years, and it cannot  
2 be undone in eight months.

3 So thank you for your time, and I'm happy to  
4 answer any questions and work with the Department on  
5 any of our comments.

6 MR. CANARY: Thank you. So I'll start. So  
7 I think both of you talked about the specifically  
8 directed provision of the definition of investment  
9 advice.

10 So consider the following. Let's deal with  
11 somebody who's actually made a specific recommendation  
12 and it's a call to action, but the person said I  
13 didn't actually know anything about the recipient of  
14 that. I didn't individualize it to them. I was  
15 saying the same thing to everyone I was providing this  
16 recommendation to.

17 So in your view would that still be covered  
18 under the investment advice definition even without  
19 the specifically directed to prong? If you need me to  
20 recite that one more time I'll try.

21 MR. ROUSE: No. That's fine. Any time that  
22 a recommendation is made, I mean, we I think are a  
23 hundred percent in agreement with you that any time an  
24 investment recommendation is made that you've crossed  
25 the line into a fiduciary role. We're comfortable

1 with that. I think where we and our members are  
2 looking for help is identifying that line more  
3 clearly.

4 MR. CANARY: Okay. So I think the word  
5 individualize is being used and personalized, so help  
6 me a little bit with what you think that line should  
7 be where the fact pattern that I've described, which I  
8 think would be covered under our proposal, would also  
9 be covered under the way you would define the  
10 recommendation component of our proposal.

11 MR. HADLEY: I would just add that  
12 individualized probably doesn't. If it's  
13 individualized you've already got that in your rule.  
14 You don't need specifically directed --

15 MR. CANARY: So you don't think  
16 individualized requires that they actually have an  
17 understanding of the needs or circumstances of the  
18 person to whom they're providing that recommendation?

19 MR. HADLEY: That's a different question  
20 from whether or not something that's specifically  
21 directed triggers fiduciary status, and that's really  
22 what we're really concerned about is that.

23 MR. CANARY: Okay.

24 MR. HADLEY: The way you defined it if it's  
25 not individualized, but it is specifically directed,

1 it looks like it's covered and we don't think you mean  
2 that.

3 MR. CANARY: Yeah. Maybe we should get your  
4 input on it. I'm still not entirely clear on where  
5 you think something is, then individualized if, for  
6 example, I'm making a recommendation to everybody in  
7 this room, you should all do the following investment  
8 action and I don't know any of these people, but I'm  
9 directing them specifically to you in an environment  
10 where it would be perceived by them as a  
11 recommendation, as a call to action.

12 But I guess are we in agreement that you all  
13 think that as long as it's specifically directed to an  
14 individual, be perceived to them as a call to action  
15 to make a particular investment, that that should be  
16 covered by the rule regardless of the term that you  
17 use for it?

18 MR. ROUSE: Yes. Whenever there's a call to  
19 action for a direct investment decision then I think  
20 we do basically agree --

21 MR. CANARY: Okay.

22 MR. ROUSE: -- that you cross the line into  
23 a fiduciary role.

24 MR. CANARY: And it wouldn't be a defense to  
25 then say I really didn't know about your individual

1 circumstances, so therefore it couldn't possibly be  
2 investment advice covered by the rule. That would not  
3 in your view be a defense or should be available as a  
4 defense to fiduciary status?

5 MR. ROUSE: Correct.

6 MR. CANARY: Okay.

7 MS. SUPOVITZ: We would agree with that.

8 MR. CANARY: Okay. Thank you. The  
9 carve-out language, I think we've talked about this  
10 before in terms of just the terminology. I think Mr.  
11 Hauser has said maybe we could have done a little bit  
12 better in terms of our terminology. Let me explore  
13 that a little bit with you and then maybe get your  
14 thoughts on what would be a better way to describe  
15 what we've done.

16 If you look at the proposal, we carve out,  
17 we use limitation when we're describing these  
18 provisions. We also use text. It didn't actually use  
19 a word to try to describe what we're trying to  
20 accomplish. Some of the provisions that we designated  
21 in the carve-outs, if you comply with them, don't  
22 involve a recommendation so I feel like the education  
23 provision, you said that doesn't involve a  
24 recommendation.

25 So a carve-out may not be the right term for

1 what that provision is, but others would actually  
2 involve conduct that would amount to a recommendation  
3 if you look at the seller's carve-out and say that  
4 envisioned circumstances where you could be making a  
5 communication or recommendation that otherwise would  
6 fit within the scope of the rule.

7           So if you're thinking about the way we  
8 should describe these provisions we were trying to  
9 capture, although with certainty people have asked for  
10 where they've said we want to be clear that education  
11 is not covered, but we're also dealing with certain  
12 conduct like the seller's provision where it actually  
13 could be covered by the general definition.

14           How would you have us describe that in a way  
15 that would reduce some of the I think confusion that  
16 people have said they have looking at the term  
17 carve-out?

18           MR. ROUSE: And we've appreciated over this  
19 morning and over the past few days your willingness to  
20 kind of go back to some of that language and help  
21 clarify that. We're very grateful that you've done  
22 that. I don't know if we can add much more than what  
23 the other witnesses have told you before. Mike, do  
24 you have anything?

25           MR. HADLEY: I mean, with education we're

1 not trying to use education to get a recommendation in  
2 disguise. We're just trying to clarify circumstances  
3 where, back to the general principle, a reasonable  
4 person would not think that they are getting fiduciary  
5 advice and clarify that in the context of education.

6 In the seller's carve-out our point really  
7 is that a small business owner can understand, just  
8 like a large business owner, that the person is a  
9 vendor, and we expect fiduciaries, all fiduciaries, to  
10 be able to have at least that amount of knowledge.

11 MR. ROUSE: And one other thing that I'd  
12 like to add to the small business aspect of it is  
13 today small businessmen have two channels in which  
14 they can buy this product. They can buy it through a  
15 benefits broker or they can buy it directly from a  
16 service provider.

17 With the way the provision is written today,  
18 that channel, that direct channel would no longer be  
19 really available to them. The likelihood is that that  
20 channel would dry up. And in many regards that may be  
21 the best channel for them, and I don't think it's your  
22 intention to close off that channel because, like I  
23 said, it may be the better solution for a plan sponsor  
24 to buy it directly, but many plan service providers  
25 would naturally close that off rather than becoming a

1 fiduciary on the plan.

2 MS. SUPOVITZ: In response to your question  
3 regarding the terminology of a carve-out, first I want  
4 to just add that another scenario, just like what  
5 you're describing, relates to the platform provider  
6 carve-out, which I guess you really have to question  
7 up front if you're offering a platform is that advice  
8 at all that even requires a carve-out.

9 So I think the way that we would view it is  
10 simply that certain things just aren't considered  
11 advice, but if things are considered advice then  
12 certain things are carved out from the fiduciary  
13 definition.

14 MR. CANARY: So let me follow up on the  
15 platform providers. Compare for me as you're looking  
16 at it platform provider and the seller's provision.  
17 At one level the notion of the platform provider was  
18 potentially a variant of a seller's carve-out for a  
19 particular type of activity, the platform provider and  
20 the assistance and the selection and the monitoring of  
21 investment options that would be available in a plan.

22 So if we adjusted the platform provider  
23 provision as you've recommended, what other sorts of  
24 sales activity in the small employer marketplace is  
25 then necessary to be covered by an expanded seller's

1 exception?

2 MR. ROUSE: Ultimately when you're selling  
3 the plan to that small plan provider, and if it is  
4 direct that there comes that moment in which you now  
5 have to take this universe of thousands of funds and  
6 decide which funds are now going to be part of that  
7 plan.

8 And many of the service providers today  
9 utilize a third party service or some other  
10 independent to allow them to do that, but based on  
11 what the regulations say in terms of recommending an  
12 investment provider that would cause the service  
13 provider to be a fiduciary, and it's our opinion that  
14 that shouldn't be the case and if it wasn't then we  
15 could then offer that service provider's  
16 recommendations and monitoring for the funds to narrow  
17 the universe down to the reasonable number that you  
18 want to offer in your plan.

19 MR. CANARY: Right. So assume that the  
20 platform provider and selection and monitoring  
21 provisions are just in the way that you think would  
22 cover that activity. What else is necessary for the  
23 small employer and the seller's provision? One of the  
24 concerns is the seller's provision is very open-ended.

25 MR. ROUSE: Yeah.

1           MR. CANARY: It doesn't really have a  
2 limitation on the type of recommendation that would be  
3 involved except for a very broad introductory section,  
4 which I know people have some questions about that  
5 scope, but it's much broader than the platform  
6 provider provision.

7           So if we change the platform provider  
8 provision the way that you're recommending, do you  
9 need small employers to be in the seller's exception,  
10 and if you do what activity are you covering that's  
11 necessary?

12           MR. ROUSE: I think that would be a major  
13 step forward and would make us much more comfortable  
14 with the small business plan provisions of the  
15 regulations.

16           MR. CANARY: Thank you.

17           MS. SUPOVITZ: Yeah. I do want to point out  
18 that the language the way it's written for the  
19 platform provider exception it's not entirely clear to  
20 us that it's available to other than the provider, and  
21 very often there are intermediaries who are actually  
22 the ones marketing those platforms and they can be  
23 third party administrators. They could be advisors.  
24 They can be others.

25           And we don't think it was the Department's

1 intent to suggest that those intermediaries that  
2 market those platforms shouldn't have the same  
3 carve-out, so assuming that that language is the way  
4 we're hoping it will be corrected to be then I think  
5 that goes a long way in answer to your question.

6 MR. CANARY: Thank you. Switching subjects,  
7 there's been a fair amount of discussion about the  
8 arbitration provision in the best interest contract  
9 exemption. Do you all share the views, either one  
10 side or the other, about the arbitration provision,  
11 whether it's a fatal flaw as some have described  
12 versus something that would be helpful?

13 MR. ROUSE: It's not come up as a primary  
14 discussion item of all the other items that we've had.

15 But, Mike, I don't know if it's come up in --

16 MR. HADLEY: We haven't talked to the  
17 members about it. We have to talk to them.

18 MR. CANARY: Okay.

19 MR. VALENTI: Nor have we focused on that  
20 particular point.

21 MR. CANARY: Okay. The platform issue again  
22 in a different context. I think there's a suggestion  
23 in the comments that the platform provider provision  
24 be expanded to the IRA market.

25 Can you talk to me a little bit about what

1 you're envisioning as a platform in the IRA market  
2 that would fit that provision and your thoughts about  
3 the difference between the ERISA space where there is  
4 an intervening fiduciary responsible for making a  
5 prudent selection of the investments that are  
6 available in that platform before they're made  
7 available to the participants and beneficiaries versus  
8 the IRA space where you don't have that kind of  
9 intervening fiduciary?

10 MS. SUPOVITZ: What we would suggest is that  
11 the platform provider carve out, allow for IRA  
12 platforms that meet one of three criteria. Either  
13 it's an open architecture platform, that it's pretty  
14 much record keeping for any say mutual fund out there,  
15 or it's a platform that doesn't offer any proprietary  
16 investments or it offers only investments that have  
17 been blessed by an independent third party fiduciary,  
18 and in a scenario like that we would recommend that  
19 the platform provider exception be extended to IRAs.

20 MR. CANARY: Okay.

21 MR. ROUSE: We would agree that any  
22 recommendation on a specific investment again becomes  
23 fiduciary, but as long as we remain within the factual  
24 context of what the plan allows that our providers and  
25 our representatives are able to talk about the

1 distribution options that are available the moment  
2 that, you know, we got into them.

3 Whether it's an open architecture or  
4 whatever platform, that becomes a different  
5 conversation and we're not limiting our service reps  
6 from any education that's necessary for participants.

7 MR. CANARY: Okay. So on the three areas  
8 you talked about, the open architecture, I gather that  
9 since the person can invest in anything that's  
10 available there isn't implicit in that a  
11 recommendation as to what to invest in.

12 MS. SUPOVITZ: Correct.

13 MR. CANARY: And in the independent  
14 fiduciary determination you end up saying we have at  
15 least in the ERISA space that it would be adopted  
16 over at the IRA space some intervening judgment being  
17 made about the appropriateness of that investment  
18 option taking into account fees, potential conflicts,  
19 et cetera.

20 MS. SUPOVITZ: Correct.

21 MR. CANARY: But in the nonproprietary space  
22 is there still a possibility that the person  
23 constructing that platform is going to have a  
24 financial interest in what's on the platform where you  
25 may have a limited range where there could be an

1 implicit recommendation and a financial interest that  
2 no independent party has evaluated?

3 MS. SUPOVITZ: Well, thinking about that off  
4 the cuff, certainly you would want a levelized  
5 compensation structure there.

6 MR. CANARY: Okay.

7 MS. SUPOVITZ: And that's the way we would  
8 envision it being designed; that it would basically be  
9 a wrap fee for the recordkeeping services.

10 MR. CANARY: Okay. I have more, but so that  
11 Tim doesn't say I'm doing the same thing he was doing  
12 maybe I'll turn it over and see if any of my  
13 colleagues would like to ask some questions.

14 MR. COSBY: Okay. I have a question focused  
15 on the small business owners. You both indicated your  
16 concern about advice to them being cut off because  
17 compensation models that advisors would receive would  
18 be affected by the rule and so there would be a  
19 prohibited transaction. I was just wondering if you  
20 could expand on that a little bit so I could  
21 understand exactly what you're referring to.

22 MS. SUPOVITZ: Uh-huh. So in a level  
23 compensation environment, pretty simple. The advisor  
24 is typically going to charge, you know, certain basis  
25 points on assets in the plan. In the small plan

1 market I guess the best example to look at is a start  
2 up plan, which of course is where we really need to  
3 and want to expand coverage. If you have a start up  
4 plan there are no assets in the plan.

5 So today there are compensation models on  
6 the commission side where the compensation is still  
7 level across all the investments offered in the plan,  
8 but it's actually commissions paid by the provider  
9 because there are no assets yet. They're fronting  
10 those commissions.

11 Under the proposal as written that would  
12 need to use the best interest contract exemption, but  
13 that exemption isn't available at the plan level to  
14 participant directed DC plans. So do you just tell  
15 all of these advisors that are helping to build  
16 coverage in that small plan market either do it for  
17 free or wait a long time before you're ever going to  
18 get paid? It just doesn't work. So that's the main  
19 reason we need to extend that BICE to that marketplace  
20 that's excluded right now.

21 MR. COSBY: And if it were extended to them  
22 they'd be receptive to the exemption and those  
23 conditions?

24 MS. SUPOVITZ: Well, I think there are a lot  
25 of other issues we'd want to tweak with the exemption,

1 but, you know, assuming the exemption gets to a point  
2 that it's workable then absolutely we would want to  
3 make that work.

4 MR. COSBY: And then still on the subject of  
5 small businesses, so right now the counterparty  
6 carve-out doesn't include small businesses, and the  
7 definition is, you know, the hundred participant  
8 definition that we've always used. I was just  
9 wondering. Do you think it should be open to plans of  
10 all sizes, or would there be any type of cutoff at all  
11 that would be appropriate?

12 Because I guess the concern is that  
13 literature has shown that small business owners have  
14 some of the same issues that individual investors have  
15 with respect to actually understanding the capacity  
16 that the investment advisor has provided them advice  
17 under and other similar issues, so I was just curious  
18 about do you think it should be open regardless of  
19 size, or is there any size limitation that would be  
20 appropriate?

21 MS. SUPOVITZ: We support the best interest  
22 standard and so when it comes to that particular area,  
23 I mean, from our point of view we don't necessarily  
24 have a problem the way it sits.

25 MR. COSBY: And I just had a question, Mr.

1 Rouse. You had talked about you were looking at the  
2 platform carve-out, and you were talking about like  
3 mapping assistance and other type of assistance.

4 I was just trying to understand more about  
5 that because it sounded like you were explaining that  
6 more or less outside of the exception, so I was just  
7 wondering what exactly you were referring to when you  
8 were talking about that type of activity.

9 MR. ROUSE: So many small plans at some  
10 point in the discussion after you've discussed your  
11 fees, after you've discussed your services and after a  
12 plan sponsor is likely to move over then there comes  
13 that moment in time, that critical moment, where it  
14 now becomes an issue of which funds do I want to  
15 include in my plan.

16 Many service providers, rather than giving  
17 advice, will utilize an outside third party to do that  
18 for that plan sponsor and allow them the ability to  
19 then narrow down the scope of thousands or tens of  
20 thousands of funds down into a number of workable  
21 funds that are available that should be made available  
22 to the participants. Does that answer your question?

23 MR. COSBY: Yeah. I was just wondering if  
24 the activity could be done within the platform  
25 exception. I guess that's what I was trying to

1 reconcile is, you know, where that's actually fitting.

2 MR. ROUSE: It's often an arrangement with  
3 the service provider and an outside service, and  
4 that's typically the way we've seen it.

5 MR. TAYLOR: And you think it would be a  
6 problem for the outside service to be considered a  
7 fiduciary or --

8 MR. ROUSE: No. They take that  
9 responsibility.

10 MR. TAYLOR: Okay. Okay.

11 MR. ROUSE: No. In here if a service  
12 provider is recommending them --

13 MR. TAYLOR: Uh-huh.

14 MR. ROUSE: -- the service provider doesn't  
15 want to become the fiduciary.

16 MR. TAYLOR: I understand. Okay.

17 MR. HADLEY: If I could just add to that?  
18 So, you know, the platform, there are sort of two  
19 platform carve-outs, one for the platform itself and  
20 one for selection and monitoring. You're trying to  
21 sort of say you can help with analytics. That's not  
22 advice.

23 And the point is there are a couple things  
24 that are like that. One is a sample menu, which is  
25 often requested by particularly large plan

1 fiduciaries. We need to see your pricing. Give us a  
2 sample. It's presented as a sample with appropriate  
3 disclosures. That seems to fit under the platform.

4 And then the other is okay, we're going to  
5 choose you. Can you give us some examples of funds  
6 that might map? We'll make our own decision, but give  
7 us some that you might have that could fit.

8 MR. TAYLOR: Just sort of objective  
9 information about the funds?

10 MR. HADLEY: Just objective information, not  
11 suggesting a recommendation. That seems similar to  
12 kind of applying a screen --

13 MR. TAYLOR: Uh-huh.

14 MR. HADLEY: -- of objective criteria.

15 MR. CANARY: Okay. So let me explore that  
16 just a little bit further because under the selection  
17 and monitoring provision it does allow for the  
18 employer to say here's the general characteristics  
19 that I want the funds to meet. What do you have that  
20 fits those characteristics? Are you suggesting that  
21 something more than that is necessary?

22 MR. HADLEY: Well, I think we're just  
23 looking for clarification that what I just described  
24 works.

25 MR. CANARY: Okay.

1           MR. HADLEY: And just to add, so, you know,  
2 sometimes a service provider is asked can you give us  
3 some criteria or might provide a sample investment  
4 policy statement, again not representing that as a  
5 recommendation to do it, but here are some criteria  
6 that we might screen for you if you'd like, and if you  
7 want us to do it go ahead. You can choose something  
8 else. And again, the language sort of suggests that  
9 the employer, the plan sponsor, the fiduciary has got  
10 to say here are the ones I want.

11           MR. CANARY: Uh-huh.

12           MR. HADLEY: Our view is they're really just  
13 approving. They have to have a say, but the service  
14 provider could suggest some and the fiduciary approves  
15 it.

16           MR. CANARY: Thank you. Okay. A couple  
17 more. There was a question which has been described  
18 in different conversations as the hire me issue,  
19 whether or not a conversation or a response from RFP  
20 or a conversation where you're suggesting that someone  
21 engage you is fiduciary investment advice because of  
22 the provision in the rule that would cover  
23 recommendations of a person to provide investment  
24 advice for a fee. So not wanting to get into that  
25 specifically, but one element of it.

1                   What are your thoughts on affiliates or  
2 related parties where it's not so much hire me, but  
3 it's hire an affiliate, a subsidiary, a related party?  
4       Should that also be excluded? And if it isn't to be  
5 totally excluded is there a need to have some clarity  
6 there that the person is an affiliate, that the person  
7 would have to understand that the nature of that  
8 recommendation is similar to hire me? It's hire my  
9 affiliate. Any thoughts on that?

10                   MR. ROUSE: Well, going back to the other  
11 example that we talked about earlier of using a third  
12 party advisor, as long as it's a third party and the  
13 service provider is offering it as a service to help  
14 the plan sponsor, I don't think it should fall within  
15 the area of fiduciary.

16                   If, on the other hand, you're recommending  
17 that you then go to a true affiliate of the  
18 organization and it's a recommendation for an  
19 investment, I think we agree that any recommendation  
20 for an investment is a fiduciary.

21                   MR. CANARY: Okay. Let me -- I'm sorry.

22                   MS. SUPOVITZ: No. That's fine. I just  
23 want to make sure I understand the question. So you  
24 were talking about if you put language into the rule  
25 that allows hire me type scenarios should it also

1 incorporate hire my affiliate?

2 MR. CANARY: You should be over here asking  
3 the questions. I think that was a fair summary.

4 MS. SUPOVITZ: That was your question?

5 MR. CANARY: Yes.

6 MS. SUPOVITZ: Okay. And we would say yes.

7 MR. CANARY: Okay.

8 MS. SUPOVITZ: Yes.

9 MR. CANARY: Let me get a little bit further  
10 into that because I think one of the comments also was  
11 that that provision should only reach a circumstance  
12 where the person is hired specifically to make a  
13 recommendation of another person to provide investment  
14 advice and is getting paid for that.

15 So let's again go to this affiliate  
16 circumstance and assume that I'm making a  
17 recommendation and I was really engaged to do that,  
18 but I am going to get a finder's fee or some sort of  
19 compensation from the affiliate for every person that  
20 engages them.

21 How do you think about that in connection  
22 with a suggested limitation that this provision should  
23 only apply in circumstances where I was specifically  
24 engaged for a fee to provide this recommendation?

25 MR. ROUSE: I think our comments we agree

1 that if you were engaged for a fee then --

2 MR. CANARY: But here there wasn't an  
3 understanding of any fee. The finder's fee would be  
4 third party compensation that the person receiving the  
5 recommendation may not know about.

6 MS. SUPOVITZ: I would say if you receive a  
7 fee that's a direct result of having made that  
8 recommendation that kind of solves both sides. So you  
9 weren't necessarily engaged, but it's not that you're  
10 receiving fees for some other service that had nothing  
11 to do with that recommendation.

12 MR. CANARY: So maybe it's not dependent  
13 upon whether I know that you're -- I'm not hiring you  
14 necessarily to pay you a fee, but to the extent that  
15 you are getting a fee for it --

16 MS. SUPOVITZ: To the extent you're getting  
17 a fee from anywhere, yes.

18 MR. CANARY: Okay. I'm still not thinking  
19 that's quite where SPARK was on this issue.

20 MR. HADLEY: I mean, our concern is kind of  
21 package of services, right? So you offer a package of  
22 services. You're not trying to do anything other than  
23 sell them. And one part of that package might be  
24 access to an advice provider and, you know, our view  
25 is if you recommend another fiduciary that fiduciary

1 is going to have fiduciary obligations.

2 And the rule talked about investment advice.

3 It has traditionally been interpreted to include kind  
4 of investment management. What we think you're  
5 worried about are consultants who are hired to provide  
6 advice by investment managers do so and get a fee for  
7 that.

8 That seems to be your concern, not -- I  
9 don't think -- sort of these package of services or a  
10 scenario where somebody comes and says, we have, you  
11 know, we'd like to make available investment  
12 professionals and there's a slate of people that you  
13 sort of have relationships with and you can say here's  
14 who we have make available to third parties, that that  
15 should be considered to be investment advice.

16 MR. CANARY: Okay. I think this is really  
17 just a SPARK comment, and if I'm reading it correctly  
18 your comments departed pretty significantly from I  
19 think the stream of comments we're getting on adopting  
20 the FINRA standards for what would constitute a  
21 recommendation.

22 If I read your comment correctly you're  
23 saying we should not do that. We should not adopt the  
24 FINRA standards in defining what would constitute a  
25 recommendation under our rule.

1           MR. ROUSE: I think we think that they don't  
2 specifically apply in the same way for these  
3 retirement plans and that there's a reasonableness  
4 standard that needs to be implemented here.

5           MR. CANARY: Okay. Help me a little bit  
6 more because I think what we've heard from other  
7 sources is people believe that there's an established  
8 sort of body of information and practices that have  
9 developed around the FINRA distinction between what's  
10 education, what's your recommendation, what's sales,  
11 what's your recommendation.

12                   And if we don't use that kind of body to  
13 help inform our definition of recommendation, which I  
14 think our preamble specifically asked whether we  
15 should be adopting some or all of the FINRA standards,  
16 and we just went with a reasonableness standard I'm  
17 thinking we're going to end up with a lot of the other  
18 commenters finding that inadequate.

19           MR. HADLEY: I guess I would just sort of  
20 respond to what the members seem to be concerned  
21 about.

22           MR. CANARY: Okay.

23           MR. HADLEY: They seem to be concerned, one,  
24 that that standard was developed for a very different  
25 set of circumstances. It was developed for a

1 different regulatory structure, as you guys would  
2 point out. It's two different regulatory structures.

3 And then second, some folks express concern  
4 that if you sort of incorporate by reference then  
5 FINRA changes something. Does that mean it gets  
6 changed here? What's the relationship? I mean,  
7 fundamentally we agree that it needs to be an  
8 individualized recommendation, but the test has to be  
9 sort of designed for the circumstances under which  
10 advice is given in the retirement space and the  
11 implication being fiduciary status, which is very  
12 different than under FINRA rules.

13 MR. CANARY: Okay. So let me make sure I've  
14 got that. To the extent that the FINRA provisions are  
15 directed at some investment recommendations and you're  
16 talking about an area where it's not so much an  
17 investment recommendation per se, but it's a service  
18 recommendation or it's a platform, that there's some  
19 question in your mind as to whether the terminology  
20 that FINRA used is going to be able to translated over  
21 into things that may not be investment specific kind  
22 of recommendations.

23 MR. HADLEY: You should be on this side. I  
24 think you've got it.

25 MR. CANARY: All right. Thank you. Then I

1 don't know. I have one more, but if --

2 MR. COSBY: Go ahead.

3 MR. CANARY: Okay. I don't think we've  
4 really talked about it too much, and it may be  
5 different in your space than it would be, for example,  
6 where we're dealing with a broker because I'm thinking  
7 that's not primarily what you're focused on is  
8 brokerage services.

9 The best interest contract provision has a  
10 contract requirement in it. To the extent that you  
11 were in need of relying upon the best interest  
12 contract exemption, do you have any concerns about the  
13 existence of a contract requirement in terms of the  
14 way your business models were structured?

15 MR. ROUSE: Yes, and I think that as we  
16 mentioned it's somewhat unworkable. And we used the  
17 example again of the small business. It would  
18 essentially close down a direct channel for small  
19 businesses, so a small businessman would not go to a  
20 service provider. At least if it did they would be  
21 told we're not going to act as a fiduciary and then  
22 force them to go through a broker sold channel. So  
23 there's, that's the concern that --

24 MR. CANARY: Okay. So just let me follow up  
25 on that just a little bit. This may also be one of

1 these scope issues. To the extent that you're really  
2 talking about the activity that let's assume would be  
3 covered by a platform provider and selection and  
4 monitoring provision as you would design it --

5 MR. ROUSE: Uh-huh.

6 MR. CANARY: -- then do you have issues with  
7 other activities for which you might need a best  
8 interest contract exemption where a contract  
9 requirement would apply?

10 MR. ROUSE: No. I think we addressed that  
11 earlier that if you have the ability to ultimately use  
12 a third party and have the platform exemption that  
13 that would address the big concern there.

14 MR. CANARY: Okay.

15 MS. SUPOVITZ: Well, certainly there would  
16 be scenarios it would apply to with what I just spoke  
17 about with small plans. If we allow those small,  
18 participant directed, noncontribution plans as part of  
19 the BICE, assuming that happens, then that contract  
20 provision would apply and at least off the cuff, and I  
21 haven't discussed it with all our members, I would  
22 assume they would have no problem with that.

23 MR. CANARY: Okay. All right. Any of my  
24 colleagues?

25 MR. TAYLOR: Lyssa?

1 MS. HALL: No.

2 MR. TAYLOR: I'd just like to ask a question  
3 or two about rollovers. I noticed, Ms. Supovitz, that  
4 you talked about that some in your own comment letter  
5 and you suggested this level-to-level alternative  
6 exemption.

7 I'd just like a better sense of if it was  
8 clear that the best interest contract applied to  
9 rollovers do you think that would be working or do you  
10 think that they really need a separate exemption to  
11 handle the rollovers?

12 MS. SUPOVITZ: Yeah. We believe that it  
13 really should be a separate exemption for a couple of  
14 reasons. So the best interest contract exemption, as  
15 you know, was designed for differential comp and so  
16 most of the provisions are aimed toward that and we  
17 don't have that scenario here.

18 Secondly, the best interest contract  
19 exemption doesn't allow for discretionary management,  
20 and of course you wouldn't want it to allow for  
21 discretionary management because if your comp is  
22 variable you could through your own discretion keep  
23 increasing your comp, so you wouldn't want to mix  
24 those two together.

25 In the scenarios that I'm describing

1 compensation is level, and very often -- most often --  
2 it's a discretionary account that's being managed, so  
3 for those reasons we really think it should be a  
4 separate, streamlined, simple exemption.

5 MR. TAYLOR: Okay. And you think that, talk  
6 about it being level-to-level, but I just want to make  
7 sure I understand. There is a move from one level to  
8 another when you do the rollover --

9 MS. SUPOVITZ: Correct.

10 MR. TAYLOR: -- obviously and so you don't  
11 believe that the same protections are necessary that  
12 we would have in the best interest just to go from  
13 that to deal with that?

14 I mean, I see billboards when I'm driving  
15 sometimes about people, you know, saying come and  
16 speak to me about taking your money out of the plan  
17 and putting it into an IRA.

18 MS. SUPOVITZ: Yes. I see them. I see them  
19 as well.

20 MR. TAYLOR: There's a lot of --

21 MS. SUPOVITZ: Yes.

22 MR. TAYLOR: -- sales activity out there.

23 MS. SUPOVITZ: Yes. And we care a lot about  
24 that issue because, you know, we're definitely very  
25 strongly in favor of the best interest standard. Here

1 we're talking about a scenario where it's strictly fee  
2 for service. It's completely investment neutral on  
3 both sides. The only question is should this person  
4 really roll over and what do they want from their IRA.

5 So if they say, you know, I really want  
6 somebody to develop a retirement income program for me  
7 and manage that for me and take into account  
8 everything that goes into that, that would always be  
9 at a different fee than the plan. We are suggesting  
10 that you document the reason it was in the person's  
11 best interest to roll into their own IRA.

12 Usually it's because plans don't allow  
13 systematic withdrawals or it might be because they  
14 simply don't want to leave their money with a prior  
15 employer. Once in a while it might be because they  
16 want investments that aren't offered in the plan. I  
17 mean, there are a variety of very valid reasons, and  
18 we just want to make sure that the kinds of advisors  
19 that this whole rule is intending to promote aren't  
20 left out of that equation.

21 MR. TAYLOR: All right. Now on the  
22 education advice -- do we have time yet?

23 MR. CANARY: You've got like one minute.

24 MR. TAYLOR: Okay. Just briefly, you talked  
25 about having --

1 MR. CANARY: Actually you don't have a  
2 minute, but go ahead. Go ahead

3 MR. TAYLOR: Okay. Fine. It's just on the  
4 education advice you mentioned that in many cases the  
5 asset allocation models are populated by fiduciaries  
6 who have no interest in the particular investments  
7 that are used to populate it, but then they are  
8 actually presented to the participants by other  
9 individuals.

10 MS. SUPOVITZ: Yes.

11 MR. TAYLOR: I just wanted to make clear.  
12 Do those individuals have interest in that?

13 MS. SUPOVITZ: No, no, no.

14 MR. TAYLOR: Okay.

15 MS. SUPOVITZ: Those individuals, to give  
16 you an example, they may even be part of the HR  
17 department of the company --

18 MR. TAYLOR: Okay.

19 MS. SUPOVITZ: -- or they may be hired  
20 educators or enrollers that are paid nothing to do  
21 with the investment.

22 MR. CANARY: All right. Thank you very  
23 much. I think with that we'll resume again at 2:15  
24 with the next panel after a lunch break.

25 //

1                   (Whereupon, at 1:16 p.m. the hearing in the  
2 above-entitled matter was recessed, to reconvene at  
3 2:15 p.m. this same day, Wednesday, August 12, 2015.)  
4 //  
5 //  
6 //  
7 //  
8 //  
9 //  
10 //  
11 //  
12 //  
13 //  
14 //  
15 //  
16 //  
17 //  
18 //  
19 //  
20 //  
21 //  
22 //  
23 //  
24 //  
25 //

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

(2:15 p.m.)

1  
2  
3 MR. HAUSER: So if everyone wants to get  
4 settled, we'll start up with the afternoon panels.  
5 Would you like to start?

6 MR. POOLMAN: If you'd like me to.

7 MR. HAUSER: Do you have a preference?  
8 Whoever wants.

9 MR. POOLMAN: I'd be happy to if you'd like  
10 that.

11 MR. HAUSER: I would just remind, if you  
12 weren't here in the morning, if you could all remember  
13 to speak into the mics for the benefit of the people  
14 that have to transcribe this. Thank you.

15 MR. POOLMAN: I'm going to go ahead and get  
16 started then. Thank you. I appreciate it and thank  
17 you for the opportunity to testify today. My name is  
18 Jim Poolman and I am an executive director of the  
19 Indexed Annuity Leadership Council, which is a  
20 consortium of life insurance companies that offer  
21 fixed indexed annuities or FIAs. Established in 2011,  
22 the IALC educates consumers, the media, regulators,  
23 and industry professionals about FIAs. IALC companies  
24 today have more than 1.3 million policyholders in  
25 force, with more than \$84 billion in assets.

1           At the outset I want to recognize the  
2 thousands of insurance agents who sell fixed annuities  
3 including FIAs and who work very hard every day to  
4 provide principal protection and guaranteed income to  
5 consumers. Extending a legal fiduciary standard to  
6 their conduct will reenforce what is already largely  
7 true today, in almost every case these hardworking men  
8 and women work to advance the best interest of their  
9 customers. But the details of the DOL final rule will  
10 make the difference between a standard that reenforces  
11 that desired conduct and one that may impede the  
12 ability of insurance agents to help consumers navigate  
13 important retirement planning decisions.

14           Fixed annuities, including FIAs, have been  
15 used by consumers for many years as part of a well-  
16 balanced financial plan and as a way to provide  
17 guaranteed income for life. The only significant  
18 difference between an FIA and other fixed annuities is  
19 the formula for computing interest earnings credited  
20 to the policy. The FIA references a market index for  
21 that purpose instead of a periodically declared or  
22 fixed rate.

23           As is the case with other fixed annuities,  
24 FIAs do not assess sales charges. They are supported  
25 by the general investment account of the insurer,

1 principal is protected from market downturns, and they  
2 are regulated by as insurance under state insurance  
3 laws, and they are sold only by state licensed  
4 insurance agents. While sometimes these agents are  
5 also registered investment advisers or registered  
6 representatives of a broker-dealer, the majority are  
7 independent insurance agents selling only insurance  
8 products.

9           The IALC appreciates the Department  
10 retaining PTE 84-24 to provide an exemption from  
11 prohibited transaction rules for insurance agents who  
12 sell fixed annuities for the purpose of preserving the  
13 traditional commission form of compensation. Unlike  
14 the proposed best interest contract exemption, 84-24  
15 reflects the dominance of independent insurance agents  
16 who sell these products and who typically do not offer  
17 other financial products. It also reflects the  
18 absence of sales charges assessed to the policyholders  
19 purchasing fixed annuities and the reliance on  
20 insurance commissions as the form of remuneration to  
21 the insurance agent.

22           84-24 is structured with the intention of  
23 making available financial advice that is a consumer's  
24 best interest notwithstanding the payment of  
25 commissions by third parties. Our comment letter

1 offers several suggestions to modify the language of  
2 84-24, some of which are technical and clarifying in  
3 nature. While not enumerating them all today, each is  
4 nonetheless important to make the rule work as  
5 intended. I will mention just a few of the  
6 substantive areas that we urge the Department to  
7 address in the final PTE.

8           The first issue is the definition of  
9 insurance commission, has three distinct issues. One,  
10 it seems to require payments directly from an  
11 insurance company to the insurance agent. However,  
12 commissions may be paid to an insurance agent by a  
13 broker-dealer with whom the agent is a registered  
14 representative or by an independent marketing  
15 organization with which the agent is contracted. Two,  
16 using the term "sales commission" to define insurance  
17 commission is too vague. And three, the complete  
18 elimination of marketing payments will impair the  
19 ability of insurers to support activities that are  
20 important to the distribution process.

21           Our comment letter suggests addressing these  
22 concerns by defining insurance commission as all  
23 taxable income. We suggest including sales incentives  
24 and marketing payments only to the extent that they  
25 are based on total aggregate sales.

1           The complete elimination of these payments  
2           is unnecessary to minimize the risk that an insurance  
3           agent might be motivated to recommend a specific  
4           product on the basis of a potential payment, rather  
5           than what it is in the best interest of the consumer.

6           The risk can be addressed by preventing such payments  
7           when they are tied to a specific product, yet  
8           permitting them when they are paid on the basis of  
9           total aggregate sales.

10           Why do they need to be preserved? Because  
11           these payments support activities that are important  
12           components of the distribution process. For example,  
13           the elimination of marketing payments to agents would  
14           be a disservice to consumers as it is the advertising  
15           by agents that actually brings greater awareness to  
16           consumers about the financial products available, the  
17           companies that provide them, and how consumers can  
18           obtain them.

19           The second issue, one of the conditions of  
20           the PTE is that the insurance agent not be paid  
21           amounts in excess of reasonable compensation. We  
22           believe that it is important to have a very clear  
23           definition of what reasonable compensation is to be  
24           able to comply. We urge the Department to adjust the  
25           definition to be clearer. Specifically, we urge the

1 adoption of a safe harbor, a standard used in the  
2 regulations under ERISA, section 408(c)(2), a section  
3 that allows fiduciaries to receive reasonable  
4 compensation for services. That regulation defines as  
5 reasonable, "such amount as would ordinarily be paid  
6 for like services by like enterprises under like  
7 circumstances."

8           The third issue, the PTE requires an  
9 insurance agent to disclose the insurance commission  
10 to the customer expressed on a percentage of gross  
11 annual premiums that is paid by the insurance company  
12 to the agent. As drafted, this requirement raises two  
13 concerns. Some forms of commission may not easily be  
14 described as a percentage of premiums. For example,  
15 health insurance or retirement benefits earned by the  
16 insurance agent and as I described earlier sometimes  
17 such payments are made by entities other than the  
18 insurance company.

19           Therefore, we urge the Department to clarify  
20 that the disclosure applies to commissions received  
21 without reference to the entity making the payment and  
22 that the disclosure be expressed as a percentage of  
23 premiums to the extent feasible and otherwise as a  
24 dollar figure with any applicable conditions and  
25 limitations explained. Our recommendations further

1 the purpose of the PTE by ensuring fulsome disclosures  
2 of commission payments.

3 With respect to the fiduciary rule itself,  
4 we urge the Department to add a seventh carve out to  
5 clarify that an insurance company does not become a  
6 fiduciary when assisting agents in communicating with  
7 their clients by providing an illustration or a quote.

8 Illustrations can be important tools for agents to  
9 help customers help understand how a fixed indexed  
10 annuity works. Similarly, providing a quote to an  
11 agent should not somehow heighten the legal  
12 obligations of an insurance company. Our suggested  
13 carve out applies to those illustrations that are  
14 intended to comply with the relevant NAIC model  
15 regulation governing illustrations.

16 In conclusion, we've attempted in our  
17 comment letter and today's testimony to suggest  
18 constructive changes to the proposed rule, PTE 84-24,  
19 that are not intended to undermine the Department's  
20 objectives. We hope that a final rule will balance  
21 the Department's desire to expand the application of  
22 ERISA's fiduciary rule with the need to maintain a  
23 vibrant distribution system of financial products of  
24 retirement savings.

25 We believe that the thousands of insurance

1 agents who will be subject to the best interest  
2 standards deserve standards that are transparent and  
3 fair, so that they can continue to serve the best  
4 interest of their customers. We appreciate the hard  
5 work that the Department has invested in this  
6 initiative and the courtesy it has extended to many of  
7 us.

8 I unfortunately was not able to attend the  
9 meeting that the IALC had with the Department of  
10 Labor, but we appreciate you being open to those  
11 meetings as well. We look forward to continuing to  
12 work with the Department as it modifies its proposals,  
13 so they will ultimately serve the best interest of all  
14 consumers.

15 MR. HAUSER: Thank you.

16 MR. BROWN: Good afternoon. My name is Dale  
17 Brown and I'm the President and CEO of the Financial  
18 Services Institute. With me representing FSI is Mark  
19 Smith, a Partner at Sutherland Asbill & Brennan. We  
20 are grateful for this opportunity to share some of our  
21 thoughts regarding the Department's fiduciary  
22 proposal.

23 The White House said when announcing the  
24 proposal that if you are willing to accept a best  
25 interest standard and give a few basic disclosures,

1 firms could set their own compensation practices,  
2 thereby preserving choice for retirement investors.  
3 We agree with this objective.

4 I want to be clear. Since 2009, we have  
5 consistently supported a uniform fiduciary standard  
6 for all financial advisors that requires them to act  
7 in their clients' best interest. We share the  
8 Department's investor protection goals and believe  
9 that a well-crafted fiduciary standard will help  
10 investors. It is also vitally important that any  
11 final rule preserves investor choice and access to  
12 quality, professional retirement advice.  
13 Unfortunately, as currently written, the proposal is  
14 too complex and costly for firms and advisors to  
15 operationalize. It fails to achieve the White House's  
16 vision because it's unworkable; it creates barriers to  
17 professional advice; and it limits investor choice.  
18 We are ready to collaborate with the Department so  
19 that the final rule creates a workable fiduciary  
20 standard that preserves investor choice and access.

21 FSI member firms license more than 160,000  
22 independent financial advisors, under both broker-  
23 dealer and RIA rules, representing more than 60  
24 percent of all producing registered representatives.  
25 These financial advisors are small business owners in

1 communities across the country, often in small towns  
2 where larger firms don't have a presence.

3 Due to their unique business model, FSI  
4 members are especially well positioned to provide  
5 middle-class Americans with the financial advice,  
6 products, and services necessary to achieve their  
7 investment goals. Our members have strong ties to  
8 their communities and know their clients personally.  
9 They help their Main Street clients make good  
10 decisions when the market is volatile and navigate  
11 major financial decisions about retirement, college  
12 funding, and purchasing a home, for example. They are  
13 there when clients face significant life events such  
14 as medical concerns, deaths in the family, and caring  
15 for aging parents. They educate their clients about  
16 the importance of participating in employer sponsored  
17 and individual retirement savings programs. It is  
18 critical that investors retain access to a financial  
19 advisor they trust because no "robo-advisor" can hold  
20 their hand through life's difficult situations and  
21 decisions.

22 As written, the proposed rule will make  
23 retirement advice too expensive for investors that  
24 typically utilize commission-based accounts. Research  
25 from a variety of sources has shown that investors who

1 work with financial advisors save more and are better  
2 prepared for retirement. For example, an April 2014  
3 study by Quantria Strategies found that retirement  
4 savings balances are 33 percent higher for individuals  
5 who have access to financial advice. The same study  
6 also found that limiting access to retirement advice  
7 leads to more investors cashing out their retirement  
8 plans and could reduce the accumulated retirement  
9 savings of these affected investors by up to 40  
10 percent.

11 Mark will now dive into more detail about  
12 the barriers raised by the proposal and our proposed  
13 solutions for how to develop a workable, uniform  
14 fiduciary standard that protects all investors.

15 MR. SMITH: Thanks, Dale, and in the  
16 interest of time, let me focus my comments today on  
17 the BIC exemption, but we'd be happy to respond to any  
18 questions you may have about other aspects of our  
19 comment letter.

20 And you all know this, since the enactment  
21 of ERISA in 1974, the Department has recognized that  
22 broker-dealers provide investment services essential  
23 to retirement savers. Consequently, the Department  
24 has over the years provided ERISA compliance  
25 structures that accommodate the commission-based

1 broker-dealer business model. In our experience, this  
2 regulatory regime, coupled with the heavy federal and  
3 state regulation to which this industry is otherwise  
4 subject, has substantially succeeded in protecting the  
5 interests of retirement savers. In the proposal, the  
6 Department appears largely to agree with us. In more  
7 than one instance, the Department observes that in the  
8 main, retirement investors are well served by their  
9 financial advisors. And this industry can testify  
10 from long experience that if a bad actor does disserve  
11 a retirement investor, there are effective remedies  
12 available today. As we see it, the Department has  
13 been presiding over a success story here.

14 The Department, of course, proposes to  
15 remake this regulatory regime in the interest of  
16 enhancing investor protections for participants and  
17 IRA owners. The expanded fiduciary definition  
18 purposefully puts real pressure on the broker-dealer  
19 business model, and we appreciate the Department's  
20 effort to preserve the availability of commission-  
21 based accounts and thus investor choice through the  
22 proposed BIC exemption. The difficulty as we see it  
23 is that the BIC exemption as proposed simply is  
24 unworkable for participants and IRA owners, as well as  
25 for our members, and let me give you four high-level

1 examples of that.

2 First, the proposed conditions governing  
3 compensation practices are not business model neutral.

4 While commission-based compensation models remain  
5 available in form, there is no clear path through the  
6 exemption that our members can rely on with  
7 confidence. The proposal leaves even good actors  
8 substantially exposed on this point. And on a related  
9 point, the constraints on certain types of investments  
10 is neither neutral nor principle-based in our  
11 judgement.

12 Second, the written contract requirement is  
13 operationally challenging and inconsistent with  
14 industry practice and investor expectations. Simply  
15 put, no one will understand being asked to sign a  
16 contract before any concrete discussion of investment  
17 possibilities has taken place or any hiring decision  
18 has been made.

19 Third, the series of disclosures required by  
20 BIC -- the point of sale disclosure, the annual  
21 disclosure, the website disclosure, and, functionally,  
22 the data request requirement -- are complex,  
23 overwhelming for retail investors, and/or duplicative  
24 with existing disclosures. The BIC disclosures would  
25 also come at a real cost, which ultimately falls on

1 participants and IRA owners. And to the extent the  
2 BIC disclosures implicitly require projections of  
3 future investment experience, they are also  
4 incompatible with other laws to which this industry is  
5 subject.

6 Finally, we like many others are greatly  
7 troubled by the prospect of a federal agency creating  
8 a private right of action under disuniform state law  
9 for a violation of a federal legal standard that  
10 itself is not created by statute. And at least in the  
11 circumstances of our industry, we can testify with  
12 certainty that ERISA fiduciary status and the best  
13 interest standard will be cited against our members in  
14 FINRA arbitrations and the other forums in which  
15 remedies exist today.

16 We should note that these consequences will  
17 fall more heavily on our smaller members than our  
18 larger members. The resource requirements to take on  
19 these conditions and exposures do not all scale. We  
20 had not thought that the Department intended to take  
21 retirement business away from smaller firms and give  
22 it to larger firms, but it may well be that the  
23 proposal will do just that, which is a particular  
24 problem in smaller communities.

25 The BIC proposal becomes unworkable and

1       impairs investor choice and access when it goes beyond  
2       the core White House concept of best interest and  
3       essential disclosures. In our comment letter, we  
4       suggested for your consideration alternative  
5       conditions that are closer to that core concept and  
6       consisting of:

7                A prudential standard to act in the client's  
8       best interest; to provide skillful, careful, and  
9       diligent advice based on the client's needs; and to  
10      disclose, avoid where possible, and otherwise obtain  
11      consent for material conflicts of interest; The  
12      adoption of written policies and procedures to manage  
13      material conflicts in reasonable and specified ways;  
14      and a more streamlined and focused set of disclosures  
15      at account opening on the web and at the point of sale  
16      that conceptually have much in common with the  
17      Department's judgments underlying the 404a-5  
18      disclosures.

19              And this is a key point, as well as my final  
20      point. These conditions could serve not only as a  
21      solution under ERISA, but also for non-retirement  
22      retail accounts under other bodies of law. The  
23      Department itself argues that retail investors can  
24      find it confusing if different rules and legal  
25      standards apply to different accounts. It is also

1 harder and more expensive for our members to serve  
2 clients if the Department, the SEC, FINRA, and the  
3 various other federal and state regulators with  
4 jurisdiction approach their common objective of  
5 investor protection in different ways. In the  
6 commentary, the Department heard from a number of  
7 these authorities about the importance of coordination  
8 with respect to the proposal and we cannot reiterate  
9 in strong enough terms that the proposal will fail in  
10 its objective of assisting retirement investors at the  
11 least possible cost to the retirement system, if  
12 functional coordination does not take place.

13 MR. BROWN: So I want to thank you again for  
14 this opportunity to share some of our thoughts  
15 regarding the Department's fiduciary proposal and  
16 provide some of our suggested alternatives. We are  
17 committed to working with you to improve the proposal  
18 in order to preserve accesses to professional  
19 retirement advice for all investors. And we encourage  
20 the Department to coordinate with the SEC and FINRA on  
21 a uniform proposal.

22 Thanks for your time. We're happy to answer  
23 questions.

24 MR. HAUSER: Thank you. Dr. Stanley?

25 MR. STANLEY: Thank you. My name is Marcus

1 Stanley and I'm the Policy Director of Americans for  
2 Financial Reform, a coalition of over 200 public  
3 interest, labor, civil rights, and business  
4 organizations that have come together to advocate for  
5 a stronger financial regulatory system.

6 Americans for Financial Reform supports the  
7 Department of Labor's proposed expansion of ERISA  
8 fiduciary duties. This expansion is long overdue.  
9 Over the 40 years since the existing DOL rule was  
10 written, retirement markets have transformed and  
11 workers have become overwhelmingly reliant on self-  
12 directed savings. Due to loopholes in the current  
13 rules, brokers providing advice on such self-directed  
14 savings can evade the fiduciary protections that  
15 Congress intended to provide to workers saving for  
16 their retirement through employment-based plans.

17 As extensively documented in DOL's  
18 regulatory impact analysis, effective regulation of  
19 conflicts of interest in investment advice should save  
20 retirement savers tens of billions of dollars  
21 annually. And there's been a concerted effort by some  
22 commenters to discredit this conclusion. However,  
23 none of the critiques we have seen has provided a  
24 convincing reputation of its fundamental findings.

25 A very wide range of independent studies

1 using different sources and methods, ranging from the  
2 analysis of decades of mutual fund returns, to natural  
3 experiments creating random variance in investment  
4 practices, to mystery shopper audits of brokers giving  
5 financial advice, have consistently found strong  
6 empirical evidence that advisor conflict of interest  
7 lead to lower investor returns, particularly given  
8 strong theoretical and experimental evidence that  
9 markets for investment products are highly unlikely to  
10 be self correcting based on consumer choice alone.  
11 These findings provide powerful support for the  
12 commonsense conclusion that advisor incentives matter  
13 enormously to retirement investors.

14 Another conclusion one can draw from these  
15 findings is that an effective rule will face strong  
16 opposition from those in the financial sector who  
17 benefit from the current system. Gains to investors  
18 who are no longer steered into high cost products  
19 generally represent losses to the seller of the  
20 investment product. So the billions of dollars that  
21 investors stand to gain from an effective rule are  
22 also billions of dollars in reduced profits for Wall  
23 Street professionals.

24 The DOL must not weaken or reverse this rule  
25 in the face of criticism from those who profit through

1 conflicted financial advice. If this rule did not  
2 impact the profit and the business models of some in  
3 the financial industry, it could not achieve its goal  
4 of benefitting investors. Furthermore, even in this  
5 initial proposal, the Department has already gone to  
6 great lengths to accommodate the concerns of financial  
7 professionals operating under potentially conflicted  
8 business models.

9           Rather than simply ban payment incentives  
10 that could create broker conflicts of interest, the  
11 proposed rule permits a range of such payments under  
12 the best interest contract exemption. So long as  
13 enforceable contractual protections are provided,  
14 conflicts are managed through appropriate policies and  
15 procedures and fee disclosures are made. In this  
16 respect, the proposed rule is far more moderate than  
17 the current regulatory scheme in the UK, which bans  
18 sales commissions all together. Under PTE 84-24, the  
19 proposed rule also continues to permit special  
20 exemptions for insurance agents who sell annuity  
21 products not defined as securities, despite the fact  
22 that many observers have singled out such annuities as  
23 having high potential for abuse.

24           Somewhat ironically in our view, critics of  
25 the rule are now saying that these accommodations to

1 industry concerns are unworkable and impractical. Of  
2 course if there are reasonable operational changes  
3 that facilitate the process of establishing the best  
4 interest contract or communicating disclosures, then  
5 such changes should be considered. But let's be  
6 clear, if a company finds it impossible to enter into  
7 a legally binding commitment to put client interest  
8 first when giving advice or to change its policies to  
9 ensure that advisors do not face incentives that  
10 conflict with the best interest of their client, then  
11 it is simply trying to evade a real fiduciary  
12 commitment.

13 We are concerned that some in the industry  
14 will not be satisfied until all concrete and practical  
15 limitations on the conflicts of interest created by  
16 incentives to sales personnel or brokers are removed.

17 This would reduce the fiduciary duty to a vague and  
18 general assurance that advice will be in the best  
19 interest of clients, even as the incentives for front-  
20 line advisors are structured to produce the opposite  
21 effect. A fiduciary standard will simply will not be  
22 effective without real, enforceable restrictions on  
23 high powered incentives to act against the clients'  
24 interest.

25 Even if nothing in the proposed rule is

1 changed, the Department will still face significant  
2 challenges in ensuring that the best interest contract  
3 exemption does not permit an appropriate conflicts of  
4 interest and that carve-outs for educational  
5 information and sales transactions are not abused. If  
6 the Department also permits the host of additional  
7 exemptions, exclusions, and accommodations requested  
8 by industry commenters, these challenges could become  
9 insurmountable. We urge the DOL to resist calls to  
10 weaken the proposed rule.

11 The Department should also not be distracted  
12 by calls to defer to other regulatory agencies.  
13 Through ERISA, Congress has entrusted the Department  
14 of Labor with the unique responsibility of  
15 safeguarding workers who save through employment-based  
16 retirement plans. Unlike the SEC or state insurance  
17 regulators, DOL's jurisdiction is not limited to  
18 particular types of financial assets, but encompasses  
19 all retirement savings that flow through employment-  
20 based arrangements. Given the central role of such  
21 retirement savings for middle class families and the  
22 special tax benefits that accrue to them, it is  
23 entirely reasonable that Congress designated these  
24 savings for special protections.

25 Only the DOL has the power to create a

1 consistent fiduciary standard that encompasses all  
2 employment-based retirement savings. And in practice,  
3 other regulators have not stepped forward with  
4 actionable and enforceable proposals to expand  
5 fiduciary protections in the areas they oversee  
6 despite the clear need for such expansion.

7 Finally, it should be clear that claims that  
8 the proposed rule will cripple access to investment  
9 advice for retirement savers are false. First is  
10 these savers who could least afford the hidden costs  
11 and the hidden fees of the current business model.  
12 Further there are numerous providers of fiduciary  
13 advice prepared to serve such savers at reasonable  
14 cost. Registered investment advisers already serve  
15 some 30 million clients under a fiduciary duty.

16 Organizations such as the Garrett Planning  
17 Network and the XY Planning Network provide face-to-  
18 face fiduciary investment advice for affordable hourly  
19 fees without any minimum asset requirements. And as  
20 discussed in the DOL's regulatory impact analysis, new  
21 developments in the provision of automated investment  
22 advice are allowing so-called robo-advisors to provide  
23 fiduciary advice at lower prices than ever before.  
24 Such technology may indeed be the wave of the future  
25 in investment advisory services.

1           It is telling that numerous comments in  
2 support of the proposed rule have come from  
3 individuals or organizations that already provide  
4 advice to low and moderate income clients under  
5 fiduciary standards, as well as organizations like  
6 Americans for Financial Reform that represent -- and  
7 our member organizations I should add, that represent  
8 many such savers.

9           Thank you for the opportunity to testify  
10 before you today. We greatly appreciate the extensive  
11 efforts the Department has made to reach out to all  
12 those affected by the proposed rule and look forward  
13 to further engagement.

14           MR. HAUSER: Thank you.

15           MR. PIACENTINI: Okay. I guess I'll start  
16 with questions for the panel and I'd like to start  
17 with Mr. Brown. So I understand that you're placing a  
18 lot of emphasis on preserving consumer choice. We've  
19 also heard some question in this hearing along the way  
20 that our analysis of the existing system didn't take  
21 adequate account of the existing protections. So the  
22 question I'm going to ask you -- actually I think I  
23 know at least most of the answers, but I want to make  
24 sure that I understand how some of the existing  
25 options work now for consumers.

1                   So if I go to one of your members and I'm  
2                   looking to make a decision between two similar mutual  
3                   funds, but maybe they come from different families,  
4                   okay, so I can see what the load is that I'll pay for  
5                   each fund and I can see if I look what the expense  
6                   ratio might be associated with each fund. So in that  
7                   sense I know what I'm paying. But how do I know, do I  
8                   know, what my advisor is being paid in connection with  
9                   a recommendation of one fund or the other?

10                   MR. BROWN: Actually, Mark is in a better to  
11                   give you that answer.

12                   MR. SMITH: Sure. Yeah, Joe, there is no  
13                   mandated individualized account level disclosure of  
14                   commissions as the regulatory regime stands right now.

15                   MR. PIACENTINI: Okay. So let's say just  
16                   hypothetically that these two funds have the same  
17                   amount of front-end load. Am I correct though that  
18                   the advisor might be paid a different share of that  
19                   load depending on which of the two funds that they  
20                   recommend?

21                   MR. SMITH: Possible, not terribly likely.  
22                   Given the compensation practices in the industry, it's  
23                   very likely that the same level of compensation would  
24                   flow through to the advisor.

25                   MR. PIACENTINI: But depending on -- I

1 understand there are these things called pay-out  
2 grids --

3 MR. SMITH: Right.

4 MR. PIACENTINI: -- that determine the share  
5 that's paid out.

6 MR. SMITH: Right.

7 MR. PIACENTINI: Sometimes the amount that's  
8 paid out can depend not only on which fund is  
9 recommended, but on how much volume of that fund the  
10 particular advisor has sold and how much revenue  
11 that's generated for the fund family; is that correct?

12 MR. SMITH: I don't know that I can answer,  
13 I can confidently answer that one for you off the top  
14 of my head.

15 MR. PIACENTINI: Okay. So let's talk for a  
16 second about some of the ongoing charges. So 12b-1  
17 fee, so I can see from the fund's prospectus whether  
18 there's a 12b-1 fee and how much it is.

19 MR. SMITH: Exactly.

20 MR. PIACENTINI: But I wouldn't know how  
21 much of that is or is not paid to my advisor?

22 MR. SMITH: Yeah, it's the same sort of  
23 structure as applies with --

24 MR. PIACENTINI: And so if the 12b-1 fee  
25 between the two is the same, the amount paid to my

1 advisor though might be different between the two  
2 funds.

3 MR. SMITH: Yeah, and I don't think --  
4 again, possible, not common, but possible.

5 MR. PIACENTINI: Okay. And I also can  
6 observe what the asset manager of the fund is paid,  
7 right, what the management fee is for the fund?

8 MR. SMITH: Absolutely.

9 MR. PIACENTINI: But I don't necessarily  
10 know whether that asset manager is paying some revenue  
11 back to the distributor, back to the advisor?

12 MR. SMITH: I think that is commonly  
13 disclosed these days in the product level  
14 prospectus --

15 MR. PIACENTINI: Would I know the amount  
16 that was paid back to the advisor, whether that was  
17 the same or different for the different funds?

18 MR. SMITH: Not necessarily.

19 MR. PIACENTINI: Okay. So let's just  
20 hypothetically let's assume that I was able to come to  
21 acquire all of this information, so I knew in detail  
22 all of this for the different funds that were offered  
23 me. As a consumer then, how would that influence my  
24 decision?

25 MR. SMITH: Let me see -- try that one

1 again.

2 MR. PIACENTINI: So let's say that as the  
3 perspective investor, now I know what the load share  
4 is for each of the funds that would be paid to my  
5 advisor. I know whether or what share of the 12b-1  
6 fee they would be paid, whether they're receiving  
7 revenue share from the asset manager and how much that  
8 would be for each of the funds. So now I have this  
9 information and I also perhaps have a recommendation  
10 now before me. The advisor is telling me that of  
11 these two similar funds, they think this is the better  
12 one to choose.

13 MR. SMITH: Okay.

14 MR. PIACENTINI: So maybe I can see that the  
15 better one, the one that's recommended is better has a  
16 larger load share paid to my advisor, but a smaller  
17 12b-1 fee. I mean should that information have any  
18 bearing on how I interpret the recommendation and, if  
19 so, what kind of bearing?

20 MR. SMITH: Well, the investor of course has  
21 definitive information on what they're paying for the  
22 investment, correct, what the friction on the return  
23 from the investment is going to be. They have  
24 definitive information about that.

25 MR. PIACENTINI: Yes.

1                   MR. SMITH: To the extent that this  
2 particular investor finds it instructive to understand  
3 what compensation is coming to the advisor -- and not  
4 all investors think about that in exactly the same  
5 way, right -- to the extent that they find it  
6 instructive, certainly there is information available  
7 in the system today to at least give them some order  
8 of magnitude notion of what kind of compensation is  
9 flowing into the distribution channel and ultimately  
10 to the advisor.

11                   MR. PIACENTINI: Okay. So, if I can, I'd  
12 like to turn my attention and ask a little bit about  
13 how things work in fixed annuity market, because I  
14 understand that things are a little bit different  
15 there.

16                   MR. HAUSER: I'm sorry, I'd like to ask one  
17 follow-up question from Joe's question, Mark. So  
18 assume, you know, we somehow manage to effectively  
19 convey the scope of the particular advisor's conflicts  
20 of interest. If I'm an investor -- and it's sometimes  
21 positive that that kind of disclosure is, you know, an  
22 alternative and perhaps better way of dealing with  
23 conflicts of interest and their impact than what we've  
24 proposed.

25                   So back to the question, so suppose I got

1 that level of disclosure. I'm an investor looking to  
2 you for, you know, expert assistance in making an  
3 investment decision that I'm not really competent to  
4 make without your assistance. What good does that  
5 disclosure do for me? How do I translate the fact  
6 that you've told me you have a conflict of interest  
7 and to better investment decision-making? Can you  
8 think of any way to do that?

9 MR. SMITH: That the possession of that kind  
10 of information by the investor translates into better  
11 investment decision-making?

12 MR. HAUSER: Right. I mean it seems to me  
13 that would be the point of disclosure. But one of the  
14 things that's always puzzled me about it, well, okay,  
15 so I have that information, what good does it do for  
16 me in making a better decision? And I haven't been  
17 able to think of the way it does. Can you?

18 MR. SMITH: Sure. I mean isn't -- the point  
19 is that you've provided more information to the  
20 investor that lets the understand the filter through  
21 which the recommendation is coming and make a judgment  
22 about whether that's a recommendation that they want  
23 to take into account or not. Isn't that the point of  
24 the disclosure?

25 MR. HAUSER: Well, I mean, so the self --

1 but that maybe tells the investor they should be on  
2 guard on whether to trust you at all. But assuming --  
3 you know, and maybe they should go to somebody that  
4 doesn't have a conflict. But how does the disclosure  
5 itself help if they stick with you in making a better  
6 investment decision or does it? Is it's only function  
7 to kind of disclose you have a conflict so they can  
8 decide to go elsewhere or does it actually help people  
9 make a better -- how is it going to contribute to  
10 better investment results?

11 MR. SMITH: You know, I'll be glad to think  
12 about that a little bit more, Tim, and get back --  
13 we'll get back to you if we have anything more to say  
14 about that.

15 MR. HAUSER: Okay, thank you. Sorry to  
16 interrupt.

17 MR. STANLEY: Can I say one? You already  
18 put your finger on the reason why a lot of us don't  
19 believe that a disclosure only approach to this is  
20 going to be effective because it puts people into a  
21 personal situation where they either insult the person  
22 across the table and essentially leave or set aside  
23 the information that they've received to some degree  
24 and that's just not something that's going to fix the  
25 problems we see out there.

1           MR. SMITH: Now if you would allow me? Our  
2 position is not that a disclosure only regime is  
3 appropriate here. Our position, and I think it  
4 largely mirrors the structure of the BIC exemption, is  
5 that a best interest standard supported by reasonable  
6 and sensible compliance procedures and a sensible  
7 disclosure regime is the appropriate solution to the  
8 issues that are on the table here. We are not  
9 advocating for a disclosure only approach here.

10           MR. HAUSER: Understood. Thank you.

11           MR. PIACENTINI: So if I could move to fixed  
12 annuities. So I understood you to improve our  
13 understanding of how the commissions work, that  
14 they're often paid through an intermediary. And then  
15 you talked about sales incentives. So are the sales  
16 incentives also paid through an intermediary or is  
17 that a reference to a payment to the intermediary or  
18 from the intermediary to the actual salesperson?

19           MR. POOLMAN: I wouldn't say that most are  
20 paid through an intermediary. They may be paid  
21 directly from the insurance company. But in some  
22 cases, the distribution process allows for an  
23 independent marketing organization to have some sort  
24 of contract where the independent marketing  
25 organization is working with the agent on whether it

1 be training, whether it be, you know, other  
2 contractual issues that they may enter into agreement  
3 with. That compensation may in some cases flow  
4 through them. And so that's what I was trying to  
5 articulate in my comments.

6 MR. PIACENTINI: Okay. And so these  
7 intermediaries and the sales forces below that, in at  
8 least some instances they're independent, so they're  
9 selling products of multiple carriers?

10 MR. POOLMAN: Correct.

11 MR. PIACENTINI: Okay. So if I understood  
12 correctly, you thought that the -- the sales  
13 incentives you described that are based on total  
14 volume of sales, that those don't have the effect of  
15 potentially influencing a recommendation of one  
16 product or another because they don't depend on which  
17 product, just on volume. But could they have the  
18 potential of influencing the choice of which carrier's  
19 product to recommend?

20 MR. POOLMAN: Potentially. But what I would  
21 say to that is that if you're representing a number of  
22 different companies and the consumer is sitting across  
23 from you and you're using the proper disclosures that  
24 we've described in our comment letter and, you know,  
25 assuming the changes are made that we think adds value

1 to the consumer, then they can say I want to see all  
2 of the products that you have potentially available  
3 and compare and contrast the disclosures that are  
4 available to them in terms of compensation.

5 MR. PIACENTINI: Okay. I asked Mr. Brown  
6 this question with respect to his area and he said  
7 that the commissions don't usually vary that much  
8 between similar products. What about with respect to  
9 the fixed annuities from different carriers and so  
10 forth, do the commissions tend to cluster very closely  
11 around a single point or is there more variation?  
12 Just generally what is the type of level --

13 MR. POOLMAN: Yeah, I think that's a great  
14 question and my response would be that they are pretty  
15 compressed as well. You know, they may vary a little  
16 bit, but typically pretty compressed. And that's one  
17 of the things actually we mentioned in our comment  
18 letter, is to provide some sort of standard by which  
19 would provide a safe harbor because we think that  
20 there is that. If you're on the outliers, which you  
21 probably shouldn't be on the outliers, then that would  
22 bring that outlier back into that bandwidth that we're  
23 talking about and that would give a consumer basically  
24 a built-in protection there.

25 MR. PIACENTINI: Okay. Another question, if

1 I understood correctly, you said that most of the  
2 sales force for these products typically sales only  
3 insurance products --

4 MR. POOLMAN: Correct.

5 MR. PIACENTINI: -- not securities.

6 MR. POOLMAN: That's right.

7 MR. PIACENTINI: So do the customers  
8 typically come already having decided what they want  
9 is an insurance product and well understanding what  
10 that means by that limitation; for example, not a  
11 variable annuity that's a security? And if not, then  
12 what happens if the customer comes in and it turns out  
13 that really what they should be looking for is  
14 something, at least in part, other than an insurance  
15 product?

16 MR. POOLMAN: Sure. Well, let me start out  
17 by saying, yes, you know, many of those folks are  
18 selling insurance only products --

19 MR. PIACENTINI: Yes.

20 MR. POOLMAN: -- and will, you know, offer a  
21 fixed indexed annuity product. That does not mean --  
22 and this is -- one of the things that we addressed in  
23 our comment letter was suitability and that the NAIC  
24 has passed suitability standards. In fact I was a  
25 former insurance commissioner and was in charge of the

1 first round of suitability at the NAIC, which is a  
2 very valuable standard for consumers. So (a) they're  
3 looking at whether or not that product is suitable for  
4 them and so is the company for that matter; but if a  
5 consumer does not see that a fixed indexed annuity is  
6 going to work for them, they certainly have the  
7 ability to go elsewhere, but they won't be able to buy  
8 a securities product from that particular agent.

9 MR. PIACENTINI: In other testimony earlier  
10 in this hearing from the perspective of a variable  
11 annuities, there was some suggestion that they should  
12 be in the same exemption, eligible for the same  
13 exemption as fixed indexed annuities or other annuity  
14 products because from the point of view -- at least  
15 one possible reason being from the point of view of  
16 the consumer, they actually look kind of similar,  
17 right. They might have similar insurance features  
18 built in. They might similarly change value with the  
19 market, for example. So that although behind the  
20 curtain they're very differently structured product,  
21 differently regulated product, from a consumer  
22 protection standpoint they might be similar. Does  
23 that fit well with any standard how these products  
24 look from the consumer side?

25 MR. POOLMAN: I don't want to sit here and

1 take a position on whether a variable annuity should  
2 be included in 84-24, but I would say that the  
3 distribution systems are different. You know, BIC is  
4 targeted to a fee-based product and this is not a fee-  
5 based product. I mean there are a whole host of other  
6 issues out there that we believe 84-24 fits for fixed-  
7 indexed annuities and a lot of that is based on  
8 distribution than how the product is structured.

9 MR. PIACENTINI: Okay. Let me circle back  
10 for just a second because I'm realizing when I was  
11 asking about commissions, I think I forgot to ask,  
12 what typically is the level of commission that's  
13 associated with a fixed index annuity sale?

14 MR. POOLMAN: We asked that question  
15 internally. Without violating any antitrust obviously  
16 issues that might be out there, but we tried to get a  
17 survey and it's about six to eight percent give or  
18 take. And that's what I mean about that fairly narrow  
19 band of compensation paid to producers out there.

20 MR. PIACENTINI: Six to eight would be a  
21 representation of a narrow band?

22 MR. POOLMAN: Right.

23 MR. PIACENTINI: Okay. So then my last  
24 question for the panel and I'd welcome an answer from  
25 anyone on the panel to this. But I've heard from this

1 panel and from a lot of folks in this hearing that  
2 there's broad consensus that the best interest  
3 standard is a good idea. In fact in some instances  
4 folks are already honoring such a standard even if  
5 they're not necessarily legally held to one.

6 I guess my question is, there is now  
7 sometimes variation in what's paid to an advisor  
8 depending on what they recommend. And presumably  
9 there's some market reason why the asset suppliers are  
10 paying different levels of compensation sometimes for  
11 similar products. So my question is, if we have an  
12 enforceable best interest standard and people really  
13 do follow it and everybody else in the market  
14 understands it's being followed, would some of that  
15 variation just naturally begin to disappear? Would  
16 there be less reason to variably compensate a  
17 salesperson if you knew that they could not, would not  
18 be taking any consideration of that variation into  
19 account when they made their recommendation? Would  
20 the variation diminish in market? Anybody wants to --

21 MR. POOLMAN: I don't think anybody wants to  
22 take a stab at prognosticating what the market may do,  
23 but --

24 MR. PIACENTINI: That's why it was my last  
25 question.

1                   MR. STANLEY: Well, I'll take a stab  
2                   although with the proviso that if I knew what the  
3                   market would do, I'd be a lot wealthier than I am now.  
4                   But we do believe that variation would diminish  
5                   because frankly we believe that some of that variation  
6                   is out there to induce people to buy particular -- or  
7                   to induce people to prioritize particular products and  
8                   the advice they give. So we do believe that variation  
9                   would diminish and we believe that some products  
10                  actually also might disappear from the market because  
11                  there are some complex products that are sold to  
12                  retail investors that are just dominated by other  
13                  products on the market that are in the best interest  
14                  of a very, very few if any investors. So we do  
15                  believe that there would be real market changes.

16                 MR. PIACENTINI: Thanks.

17                 MS. HALL: I have one question for Mr.  
18                 Smith. In your testimony, in your written and oral  
19                 testimony, you said there is no clear path through the  
20                 exemption that our members can rely on for confidence.  
21                 And I suppose you're talking about the BIC exemption.

22                 MR. SMITH: Yes, ma'am.

23                 MS. HALL: Can you elaborate on that a  
24                 little bit more? Because it sounds like you're saying  
25                 you don't understand, you need a little more clarity,

1 not that you can't.

2 MR. SMITH: You're right. And let me speak  
3 to this point. We see no structural reason why  
4 broker-dealers cannot serve the best interest of their  
5 clients. There's a premise in that, several premises  
6 in that, one of them including the market reality that  
7 there are variations in compensation among product  
8 types and among product manufacturers within a type  
9 does not by itself mean that advice cannot be in the  
10 best interest of the investor.

11 We see some indications in the preambles  
12 that you all see that the same way. There are a  
13 variety of compliance procedures that under the  
14 warranty or otherwise that are part of the exemption.

15 We see some indication that you all think approvingly  
16 of, for example, some of the FINRA procedures with  
17 which our members are very familiar.

18 We're trying to get from the concern --  
19 well, we're trying to get to -- we're looking -- it  
20 really is a question of -- if I'm right about all of  
21 that, then it's really a question of certainty. It's  
22 getting from the this might work under the exemption,  
23 to this would work under the exemption. And to the  
24 extent you can help us get there, then it seems to us  
25 the workability of the BIC exemption improves in a

1 material way.

2 And in particular on my point about  
3 neutrality among business models, to the extent that  
4 you can give us greater certainty that there is a path  
5 through the exemption that a commissioned-base model  
6 in economic realities of today's marketplace can  
7 accommodate, then that is a significant advance in  
8 terms of the work -- it would be a significant advance  
9 in the workability of the proposal.

10 MR. HAUSER: Okay, thank you. May I just  
11 ask, you know, one thing to think about, not just for  
12 you all, but for all the folks we've talked to, if  
13 you're going to submit additional comments, more  
14 comments on that precise point would be helpful.

15 You know, we indicated in the exemption that  
16 we did not intend to adopt a level fee structure, that  
17 we weren't mandating a level fee structure, but we  
18 were and did intend to prohibit, you know, incentives  
19 that were contrary to a best interest standard and  
20 that we didn't want to -- well, I guess what I'm  
21 saying is it would be helpful to get some suggestions  
22 as to what those policies and procedures might look  
23 like.

24 I mean virtually everybody who has come in  
25 here to talk to us has said that they think they act

1 in their customer's best interest. They support a  
2 best interest standard. It seems like if that's the  
3 case, there would be policies and procedures extant  
4 that, you know, are calculated to avoid rendering  
5 advice that runs counter to the customer's best  
6 interest. But it's concerning for that reason that so  
7 far we haven't gotten just a flood of, you know,  
8 suggestions of, well, here's a policy and procedure  
9 you could use as an illustration. And so I would just  
10 invite everybody, you know, to give those kind of  
11 examples if you think you've got them.

12 MR. SMITH: We'll be glad to and, look,  
13 we've got one. We think that the FINRA conflict of  
14 interest report from 2013, which you all cited  
15 approvingly in the preamble, we think that provides  
16 a -- certainly within the circumstances of our  
17 industry, we think that provides an effective model  
18 for addressing those sorts of conflict sorts of  
19 procedures.

20 MR. CAMPAGNA: Mr. Poolman, I would like to  
21 explore with you a little bit your suggestion as to  
22 the safe harbor or the carve-out regarding  
23 illustrations. Maybe I don't quite understand how it  
24 would work or maybe there's not enough detail, but it  
25 kind of rings a bell in my mind about our investment

1 carve-out regarding a description of the investment  
2 alternative being offered, type of risk. Is there  
3 anything I'm missing here or is there something unique  
4 about your --

5 MR. POOLMAN: Let me just give you a little  
6 background, if I can, about an illustration. Many  
7 times an illustration is used to explain the benefits  
8 and educate consumers about the product. Insurance  
9 companies provide an illustration to the agent to give  
10 to the customer. And our suggestion, our only  
11 suggestion there is that the insurance company, they  
12 not be held as a fiduciary only because they're giving  
13 a piece of educational material to the consumer.

14 The NAIC just not too long ago passed a  
15 disclosure model basically that is very specific about  
16 what should be included in that illustration and we  
17 see that as the standard by which insurance companies  
18 will follow to be able to utilize that illustration  
19 and so, therefore, the insurance company is not  
20 sitting down at every sale when that illustration is  
21 being used. Thus the company ought not to be declared  
22 as the fiduciary.

23 MR. CAMPAGNA: Dr. Stanley, there's a great  
24 deal of discussion earlier today and in the last  
25 couple of days about excluding from our definition or

1 actually re-including this idea of mutuality in this  
2 agreement or understanding. Your comment letter kind  
3 of went the other way. You said by virtue of a  
4 specific investment -- or a specific direction to make  
5 an investment, that should be determined to be an  
6 understanding. So did you want to weigh in at all  
7 about this debate that we're kind of having?

8 MR. STANLEY: Well, I think the concern was  
9 that if the advisor can essentially veto the idea that  
10 a contract was entered into by saying, well, I didn't  
11 understand that, if it becomes a sort of subjective  
12 situation where the advisor can simply deny that he  
13 had an understanding that there was an agreement to  
14 provide advice, even if the sort of more objective  
15 circumstances would indicate that a piece of advice  
16 was being given and the client said that he understood  
17 that as advice, then that would be a concern to us.

18 MR. CAMPAGNA: Mr. Smith, I'm going to take  
19 you up on your offer to discuss your comment letter a  
20 little bit. You wanted to extend the platform  
21 provider carve-out to IRAs.

22 MR. SMITH: Yep.

23 MR. CAMPAGNA: And you talked in terms of,  
24 well, if there's a set menu or a standardized product  
25 that's being offered, that shouldn't be included or we

1 should, you know, put that into the safe harbor, adopt  
2 that to IRAs. Can you illustrate to us or tell us a  
3 little bit about this standardization process and how  
4 it actually works? And is there any discussion with  
5 the IRA owner at all regarding how it's going to be  
6 set up? Are there any discussions with the client?

7 MR. SMITH: Well, certainly at the point of  
8 sale, there certainly are discussions going on with  
9 the client as always about the nature or the  
10 opportunity, certainly its pertinent terms, how it  
11 might fit with their needs and tolerances and so  
12 forth. It's certainly the case that's going on at the  
13 point of sale. The question is whether just being in  
14 the marketplace, in terms of offering an IRA and an  
15 IRA that's not an open-ended, self-directed IRA, but  
16 an IRA that may be tied to a particular product, tied  
17 to a particular product menu, IRA tied to a particular  
18 asset allocation I suppose.

19 Just being in the business of offering that  
20 is not -- doesn't rise to kind of fiduciary activity  
21 in and of itself. It's a comparable concern to the  
22 platform exception as it stands for the qualified plan  
23 market and it seems to us that there's simply a  
24 comparable point to be made about folks that are in  
25 the business of offering IRA platforms as well.

1           MR. CAMPAGNA: Do you agree at all with the  
2 rationale as to why the IRAs aren't included that we  
3 stated in our preamble about plan fiduciaries get a  
4 chance at least to look over this menu, but in the IRA  
5 context that's not the case. I mean, how would you  
6 rebut that?

7           MR. SMITH: We distinguish between kind of  
8 the business, just being in the business, offering for  
9 sale, you know, plan platform, IRA platform, just  
10 being in the marketplace from what's going on at the  
11 point of sale. We don't think that turns on whether  
12 there's a fiduciary in between the offeror and the  
13 retirement investor that's making a judgment about  
14 that. We think it's simply -- we simply think it  
15 being in the business.

16          MR. HAUSER: Well, when you're thinking  
17 about a platform provider exception in the IRA market,  
18 so, I mean, obviously one way to interpret what you  
19 just said is it's always open to a financial service  
20 provider to say here's what I have to offer --

21          MR. SMITH: Right.

22          MR. HAUSER: -- this is it --

23          MR. SMITH: Right.

24          MR. HAUSER: -- you know, make up your own  
25 mind. I'm not recommending anything to you.

1 MR. SMITH: Right.

2 MR. HAUSER: That's one view. Another is  
3 extending that to an actual recommendation. You know,  
4 I have narrowed the universe of investment options  
5 down to these, you know, and you should rely upon  
6 them. You're not looking for a carve-out for that in  
7 the latter circumstance are you?

8 MR. SMITH: We're looking -- and, Tim, you  
9 know, the points you've made earlier about the  
10 limitations of a recommendation FINRA sense does not  
11 help to answer this question, I think it does help to  
12 answer this question. But it does seem -- we're  
13 talking about conceive of a spectrum that has arm's  
14 length sales activity at one end, trusted investment  
15 advice at the other end, and we're trying to define,  
16 when you go from one to the other, in a way that 404  
17 and 406 and 4975 ought to be in play, right?

18 MR. HAUSER: Yep.

19 MR. SMITH: And it seems to us there's  
20 something useful about approaching that from both ends  
21 of the spectrum. That seems to us useful conceptually  
22 and useful operationally as well. And we're  
23 focused -- you know, the absence of a recommendation  
24 in the FINRA sense to any particular investor is  
25 helpful here. To the extent that we can make that

1 even clearer through the platform exemption, I think  
2 that gives some additional comfort to our members in  
3 the market. That's the point.

4 MR. HAUSER: I see. Thank you. And I'd to  
5 go back to the policies and procedures and in  
6 particular to the requirement in the best interest  
7 contract exemption, variously been referred to as the  
8 BICE or the BIC exemption. Personally I think the  
9 best interest contract exemption is very musical.

10 MR. SMITH: Hard to dance to.

11 (Laughter.)

12 MR. HAUSER: But the idea, you know, the  
13 idea of that exemption on the whole is that at some  
14 level, we're going to tolerate a fair number of  
15 compensation streams that normally would be flatly  
16 prohibited because of the potential, you know,  
17 incentives they create for the people recommending the  
18 products. But the idea of that warranty prohibiting  
19 incentives and quotas and bonuses and what have you  
20 that, you know, that run contrary to the best interest  
21 standard is that we want policies and we want  
22 incentives that align the advisors' interest with the  
23 interest of the customer.

24 So I guess my question, which, you know,  
25 maybe is the way I should have put it the first time

1 around was, I mean, is that naive? Is there some  
2 reason why -- the firm can price these products  
3 however it wants -- you know, the manufacturer can.  
4 But when it comes to the guy delivering the advice to  
5 the customer, is there some reason why you can't, you  
6 know, warrant that that person is not going to be  
7 given an incentive to do -- you know, to push the  
8 product that isn't the right one for the customer, you  
9 know, that isn't prudent, that runs contrary to the  
10 best interest standard?

11 MR. SMITH: I don't think it's naive to  
12 think that we can do that.

13 MR. HAUSER: And then the other thing and I  
14 guess just a cautionary word, I mean, you know, a lot  
15 of folks have given guidance and we have received some  
16 suggestions on policies and procedures and you did  
17 make some suggestions. But one thing I'm at least  
18 thinking hard about as I look at these suggestions is  
19 lurking in these policies and procedures, is there a  
20 sense in which the firm's conflict of interest is just  
21 being directly transmitted to the advisor?

22 And that would worry me. If the policy and  
23 procedure essentially says the more money this  
24 recommendation will make for the firm, the more money  
25 I'm going to pay you, that's aligned all right, but it

1 doesn't necessarily seem like it's aligning the  
2 advisor's interest with the customer. So I guess  
3 there's not going to be a question there since we're  
4 out of time, but if you could think about that when  
5 you --

6 MR. SMITH: We'll be glad to think along  
7 those lines.

8 MR. HAUSER: -- and provide comments. Thank  
9 you. Thank you very much.

10 (Panel switch.)

11 MR. HAUSER: Let me know when you're set.  
12 Okay. Ms. Rittenhouse?

13 MS. RITTENHOUSE: Okay. Good afternoon.  
14 I'm Linda Rittenhouse --

15 (Timer chimes.)

16 MS. RITTENHOUSE: Already?

17 (Laughter.)

18 MR. HAUSER: We have to get a little tougher  
19 now because we're towards the end.

20 (Laughter).

21 MS. RITTENHOUSE: I'm Linda Rittenhouse,  
22 Director of Public Policy, a CFA Institute. We  
23 appreciate the opportunity to offer our views today on  
24 the recent DOL fiduciary duty proposal. We know that  
25 this has been a controversial endeavor and we commend

1 the Department for stepping into the fray.

2 CFA Institute is a global membership  
3 organization of more than 133,000 members in 151  
4 countries with over 125,000 holding the Charter  
5 Financial Analyst or CFA designation. Our membership  
6 is diverse, including investment analysts, portfolio  
7 managers, chief investment officers for mutual funds,  
8 private wealth, pension funds, and other investment  
9 professionals. It is as a representative of this  
10 diverse group that I'm happy to provide comments on  
11 the DOL's effort to hold advice providers to the best  
12 interest standard when serving ERISA retirement plans  
13 and IRA account holders.

14 Regardless of their profession, all CFA  
15 Institute members are bound by the commitment to abide  
16 by the CFA Institute code of ethics and standards of  
17 professional conduct. This requires all of them to  
18 act for the benefit of their interest and place their  
19 client's interest before their employers or their own.

20 They all must specifically act with loyalty, duty,  
21 and prudence. These are not light undertakings.  
22 Members must attest on an annual basis to their  
23 compliance or risk losing their charter.

24 Thus we strongly support DOL's aim to put  
25 clients interests first. We have long said that all

1 personalized investment advice should be held to the  
2 same standard regardless of the title of the provider,  
3 be it broker or advisor with an "o" or counselor. We  
4 applaud the DOL for taking this important first step  
5 to actualize this objective.

6           Retail clients, all investors, should be  
7 able to trust that the advice they receive is  
8 impartial and not compromised by conflicts of interest  
9 that may arise from revenue sharing arrangements or  
10 limiting recommendations to certain firm products.  
11 Otherwise what happens to the integrity of our  
12 marketplace?

13           While the proposal is not perfect, it does  
14 start from a place that seeks to restore this original  
15 intent of ERISA that requires duties of prudence and  
16 loyalty. We've been impressed with your stated  
17 willingness to consider all comments raised and to  
18 acknowledge areas that are in need of redraft or  
19 clarification. We've also appreciated your attitude  
20 that we've heard on numerous occasions that your  
21 intent is not one of gotcha, but instead of investor  
22 protection. Thus, your willingness to clarify areas  
23 that have been problematic, most specifically the best  
24 interest contract exemption, bodes well for making  
25 this final rule much more workable.

1                   So now to the actual proposal. We  
2 wholeheartedly agree that the current five-part test  
3 is inadequate, does not honor the statutory definition  
4 of fiduciary and allows for conflicted advice, higher  
5 costs, and the sale of inappropriate investment  
6 products to investors. Committing to replace this  
7 test alone we feel is a major step forward in  
8 providing investors with the protection they deserve.

9                   We also strongly support the rule's carve-  
10 out from the definition of investment advice that  
11 allows a range of educational materials to be provided  
12 to investors. We have a longstanding position that  
13 investors must receive the information they need to  
14 make informed investment decisions. This is never so  
15 important as today when individual investors have  
16 greater responsibility for understanding their  
17 retirement options, planning their future, and  
18 managing their retirement assets through participant  
19 directed plans. Simply, they need the educational  
20 tools. We encourage the final rule to retain the  
21 provision that neither the frequency nor the form of  
22 these materials really matter as long as they do not  
23 include advice or recommendations as to specific  
24 investment managers or products.

25                   We also are not convinced that requiring all

1 advice providers to adhere to a fiduciary duty or meet  
2 the conditions of the best interest contract exemption  
3 will eliminate all retirement advice with a smaller  
4 investor. Nor do we agree with the argument we've  
5 heard that conflicted advice is better than no advice  
6 at all. Instead, we believe that investors will  
7 continue to receive the retirement advice they need  
8 and technology and providers will step in to fill  
9 whatever void is probably temporarily created.

10 We do have some concerns about the proposal,  
11 however, that fall primarily into this best interest  
12 contract exemption realm. First, we do believe that  
13 proposal as written is too complex. This complexity  
14 and the resulting confusion will lead to unnecessarily  
15 high compliance costs and ultimately dilute the  
16 effectiveness of it. When the duty to comply first  
17 arises, whether the advice provider can have  
18 preliminary conversations and how the sequence of  
19 events will work on a practical level all need to be  
20 addressed. We urge the Department to specifically  
21 discuss the parameters of when certain actions will  
22 first trigger the responsibilities under the  
23 exemption.

24 We also encourage a review of the numerous  
25 actions required under the exemption with an eye to

1 streamline those that are not necessary for achieving  
2 this best interest standard. For example, we note in  
3 our letter, comment letter, that the proposed point of  
4 sale disclosures are too onerous as drafted, and  
5 instead we recommend consideration of a Surgeon  
6 General type warning discussed in the proposal.

7           Secondly, we also hope the Department will  
8 provide more comfort as to when legal liability will  
9 attach. We support the new private right of action  
10 for IRA account holders, but understand that this and  
11 execution of contracts create concerns in the  
12 industry. We also understand the trepidation caused  
13 by just entering into contracts and the resulting  
14 legal costs to defend actions when recommendations are  
15 later questioned by investors, even if the contract  
16 was executed correctly. To that end, we encourage the  
17 DOL to issue guidance or discuss more directly in the  
18 final rule the areas that most likely will lead to  
19 legal liability, so that the industry has more  
20 certainty about the rule's boundaries.

21           Third, we are concerned about investor  
22 confusion that may arise from the standard of care  
23 that applies to the retirement arena, but not other  
24 areas. While the DOL is creating a best interest  
25 standard for all advice providers under ERISA, the SEC

1 has not yet introduced a uniformed standard that will  
2 apply to all who provide personalized advice to retail  
3 investors. As a consequence, we're concerned that  
4 investors may expect a broker-dealer, who is providing  
5 retirement advice, to also be honoring a best interest  
6 standard when advising as to non-retirement assets.  
7 We encourage the DOL then to work closely with the SEC  
8 when finalizing this rule to reconcile to the degree  
9 possible this investor confusion issue.

10 In sum, we support this undertaking. We  
11 suggest that the DOL consider all reasonable ways to  
12 simplify the exemption, to reduce the compliance cost,  
13 to better define the parameters of when duties kick  
14 in, and to clarify legal liability under the rule, so  
15 as to more clearly define the risks. Finally, we hope  
16 that the Department and the SEC will consult closely  
17 in adopting the final rule.

18 Thank you.

19 MR. HAUSER: Thank you. Ms. McBride?

20 MS. MCBRIDE: Thank you. I am Kathleen  
21 McBride, an Accredited Investment Fiduciary Analyst  
22 and a CEFEX Certification Analyst with the Centre for  
23 Fiduciary Excellence, CEFEX. I serve as Chair for the  
24 Committee for the Fiduciary Standard, a non-partisan,  
25 all-volunteer group of investment professionals and

1 fiduciary experts, formed to advocate that all  
2 investment and financial advice be rendered as  
3 fiduciary advice and meet the requirements of the  
4 Committee's five core fiduciary principles. All of  
5 the Committee's work is pro bono.

6 The five-core fiduciary principles are put  
7 the client's best interest first, act with prudence,  
8 that is the skill, care, diligence, and good judgment  
9 of a professional, do not mislead clients, provide  
10 conspicuous full and fair disclosure of all important  
11 facts, avoid conflicts of interest, fully disclosure  
12 and fairly manage in the client's favor, unavoidable  
13 conflicts.

14 We are challenging the status quo to ensure  
15 that all Americans can achieve a dignified, secure,  
16 retirement. I testify in support of this DOL  
17 Rulemaking. It is long overdue. I'll touch on three  
18 topics today: rollovers and harm to investors,  
19 debunking the myths about the DOL's proposal, and the  
20 perverse effects of disclosure.

21 Thank you for proposing a strong fiduciary  
22 rule that will eliminate many conflicts of interest  
23 that harm America's retirement investors. Americans  
24 who work and sacrifice to invest for their retirement  
25 should not have their nest egg diminished by Wall

1 Street and insurance companies that place their own  
2 interests before the retirement investors they are  
3 supposed to serve. Their short-term greed ensures  
4 only one that America's retirees will not have the  
5 spending power in retirement that's good for the  
6 economy, that they could have with advice that's in  
7 their best interest.

8 We applaud DOL for prohibiting a seller's  
9 exemption for retail investors, including IRA owners.

10 DOL has proposed a rule based on the North Star of  
11 fiduciary obligation and that is paramount. Now we  
12 will finally close the unintended loopholes that  
13 enabled the systematic looting of assets from  
14 America's retirement investors for decades.

15 DOL has used its rulemaking authority to  
16 include IRA investors under this proposal, including  
17 advice on whether it is in their best interest or not  
18 to roll retirement plan assets from 401(k)s into IRAs.

19 This has been an investor crossroad that's vulnerable  
20 to spectacular egregious harm, a wild west of abusive  
21 strategies by some of the industry entities to grab  
22 enormous amounts of retirement money from hard-working  
23 retirement investors just as they will need this money  
24 most.

25 When retirement investors are making the

1 decision whether or not to roll retirement savings  
2 into an IRA, they are at their most vulnerable. This  
3 fact is not lost on non-fiduciary sales reps of banks,  
4 broker-dealers, insurance companies, and mutual fund  
5 companies. It is the subject of enormous planning,  
6 strategy and training at firms that seek to capture  
7 retirement investors' assets, along with unreasonably  
8 high commissions and fees.

9           And it is here that retirement investors are  
10 often caught off guard. As one behavioral economist,  
11 who has done much research on the effects of  
12 disclosures in advisor and investor behavior, points  
13 out: "It is very hard to say 'no' to the  
14 representative sitting at your kitchen table, even if  
15 you know that what they are telling you to do is not  
16 in your best interest."

17           Here's an example, one investor, a Navy vet  
18 who went into the private sector after the Navy,  
19 accumulated a combination of traditional, defined  
20 benefit pension plans, and 401(k)-type plans. He was  
21 the beneficiary of two multibillion-dollar pension  
22 plans, which send retirees a monthly check for life.  
23 Shortly after his 65th birthday, he got a phone call  
24 from an advisor claiming to work with one of the  
25 traditional pension plans. He wanted to discuss this

1 retiree's retirement situation. This advisor began by  
2 asking whether this retiree was confident he'd have  
3 enough to live on for the rest of his life.

4 This advisor insinuated that the Fortune 40  
5 and Fortune 15 companies with the traditional pension  
6 plans might go out of business, taking this retiree's  
7 monthly payment with them. What would he do then?  
8 This advisor strongly urged this retiree to take the  
9 lump sum payouts from his two pensions -- six-figures  
10 -- and put his money into a guaranteed annuity in an  
11 IRA at this mutual fund company, a major one. Sure,  
12 it would pay this retiree several hundred dollars less  
13 each month than the pension plan would pay, but it  
14 would be guaranteed. He hounded this retiree until  
15 this retiree did rollover one of his pension plans to  
16 an IRA at that fund company, ready for that annuity.

17 It is too late for this retiree to reverse  
18 his lump sum pension payout, so he now has to find a  
19 way to replace that retirement income his pension  
20 would have provided for life. He did not buy the  
21 annuity by the way.

22 While he will not be taking more advice from  
23 this advisor, the harm has already been done. This  
24 happens every day to thousands of America's retirement  
25 investors and this is the model that Wall Street and

1 insurance special interests seek to protect.

2 Let's be clear, conflicted advice is not  
3 advice. It's sales masquerading as advice. Bona fide  
4 advice must be in the best interest of the investor.  
5 And when firms say that they will not provide advice  
6 if they have to be fiduciary, that's probably good for  
7 investors. To put it another way, brokers, banks,  
8 insurers, and mutual fund companies want to preserve  
9 the status quo that allows them to continue to  
10 systematically exploit unintended loopholes in 40-year  
11 old ERISA regulation and bleed retirement investors  
12 for every dollar they can grab.

13 But we know the fiduciary model works.  
14 Registered Investment Advisers already act as  
15 fiduciaries, in their clients' best interest. They're  
16 already serving plans and retirement investors as  
17 fiduciaries across all account sizes in retirement and  
18 non-retirement accounts. The DOL's proposal is  
19 workable, it is doable and, by the way, it is  
20 profitable.

21 RIAs are advising millions of investors.  
22 They now advise or manage \$67 trillion through more  
23 than 11,000 RIA firms. They employ 750,000  
24 individuals and serve 30 million clients.

25 As for small plans, fi360, which provides

1 on-line tools for training and for advisors has tens  
2 of thousands of retirement plans that they actually  
3 can see data on. More than half of these plans are  
4 under \$100 million. So there is no merit to the  
5 argument the small plans can't get fiduciary advice,  
6 they are, and that's just one small company segment.

7 Let's debunk some of the myths about the  
8 fiduciary standard for retirement advice.

9 Myth #1, it costs more to get advice from a  
10 fiduciary. Opponents to the DOL's proposal claim the  
11 fiduciary standard would raise costs to investors and  
12 reduce access to advice and investment products.  
13 That's not true. According to the latest fi360  
14 Fiduciary Standard survey that measures attitudes of  
15 financial intermediaries' across the board of all  
16 kinds toward the fiduciary standard, the survey asked,  
17 "Do you believe it cost more to work with fiduciary  
18 advisors than brokers, when all costs to the investor  
19 are considered?" Ninety one percent of the  
20 respondents say no, it does not cost more to work with  
21 a fiduciary advisor than with a broker.

22 Many of the comments from the survey  
23 respondents indicate that instead of a higher cost to  
24 the investor to work with a fiduciary advisor, it  
25 actually costs investors less. There's a lot of

1 academic research that supports this.

2 Myth #2, it would cost us too much to  
3 provide fiduciary advice. We'll have to pass those  
4 costs along to investors. The survey asked: "Do you  
5 believe a fiduciary standard of care would price some  
6 investors out of the market for investment advice?"  
7 Survey respondents say, no, it would not. Eighty-  
8 three percent say, no, the fiduciary standard would  
9 not price some investors out of the market for advice.

10 Myth #3, if we are forced to provide advice  
11 that's in the investor's best interest, we will  
12 abandon retirement investors. That threat sounds like  
13 blackmail and it's really bad form. Opponents of the  
14 fiduciary standard claim products and services would  
15 be reduced if brokers were required to act as  
16 fiduciaries. What they really mean is if they had to  
17 act as fiduciaries, they couldn't sell the high risk,  
18 high commission products that they sell now, because  
19 those would not be in the investor's best interest.  
20 And remember, brokers and insurance reps don't provide  
21 advice now and certainly not to smaller investors.

22 The survey asks, "Do you believe a fiduciary  
23 duty for brokers who provide advice would reduce  
24 product and service availability for investors?"  
25 Seventy-eight percent say no, fiduciary duty for

1 brokers who provide advice would not reduce product or  
2 service availability to investors.

3 Many added comments, saying that this was an  
4 opportunity and that they would step up with  
5 additional fiduciaries to serve investors. In  
6 addition, a few wrote this would filter out products  
7 that may be suitable, but are not in the client's best  
8 interest and that's a good thing.

9 Just one second on disclosures. Disclosures  
10 are necessary but not sufficient to fulfill fiduciary  
11 duty. In fact, they are often ineffective or worse.  
12 The effects of disclosures are surprising and quite  
13 unsettling. Regulators may not be aware of the  
14 effects even good disclosures have even on well-  
15 meaning advisors and investors.

16 According to Daylian Cain of Yale,  
17 "Conflicts of interest can lead experts to give biased  
18 and corrupt advice, and although disclosure is often  
19 proposed as a potential solution to these problems, we  
20 show that it can have perverse effects. First, people  
21 do not generally discount advice from biased advisors  
22 as much as they should even when conflicts of interest  
23 are disclosed and, second, disclosure can increase the  
24 bias in the advice that leads advisors to feel morally  
25 licensed and strategically encouraged to exaggerate

1 their advice even further. As a result, disclosure  
2 may fail to solve the problems created by conflicts of  
3 interest."

4 But worse, the most recent work on  
5 disclosures indicates that the effects are extremely  
6 perverse and that when disclosures are made, even  
7 well-meaning advisors give worse advice and investors  
8 are much more likely to take that advice.

9 MR. HAUSER: Thank you.

10 MS. MCBRIDE: Thank you for the opportunity.

11 MR. HAUSER: Thank you. Mr. Mason?

12 MR. MASON: I'm not quite sure it was great  
13 to go first or third here, but I'll adjust. My name  
14 is Kent Mason --

15 MR. HAUSER: Did we get the sequence wrong?

16 MR. MASON: Yeah.

17 MR. HAUSER: I'm sorry.

18 MR. MASON: My name is Kent Mason. I'm a  
19 partner in the law firm of Davis and Harman. I had to  
20 memorize that. I'm speaking today on my own behalf  
21 based on extensive conversations with plan sponsors  
22 and financial institutions and I very much want to  
23 thank you for the opportunity to appear here and thank  
24 you for your patience over what will be four days.

25 And I think my core message today is that

1 the Department and the retirement community in general  
2 have a great opportunity here, a great opportunity to  
3 do a tremendous amount of good. There's also a risk  
4 of very significant harm and I think this -- or the  
5 sort of result of which path we end up going down is  
6 going to depend on whether the Department, the  
7 industry, and the participant groups can work together  
8 to sort of address some of the difficult issues sort  
9 of arising in this very important issue.

10 I think for the past four-and-a-half years  
11 and it's certainly very clear right now, there really  
12 has never been a debate about whether financial  
13 advisors should be required to act in the best  
14 interest of the customers. I think that the industry  
15 has been fine with that from the beginning. The  
16 debate has really in my mind centered on two  
17 questions. One, if the proposal is finalized in any  
18 form sort of similar to its current form, would the  
19 industry reduce services to small accounts and small  
20 businesses; and second, if that's true, how can the  
21 rules be restructured so that the Department can  
22 achieve its very worthy goals without that adverse  
23 effect?

24 And those are the questions I'm going to  
25 address. And I've spent a huge amount of time in the

1 last few months talking to dozens and dozens of  
2 financial institutions and let me just describe to you  
3 what they're saying to me very, very clearly and very  
4 uniformly about what they would do under this  
5 proposal.

6 First, there is no financial institution I  
7 have talked to that would use the BIC or is even  
8 really seriously considering using the BIC exemption,  
9 none, zero. Now I've heard secondhand that there are  
10 a few who are thinking about using it. And my follow-  
11 up questions has always been, within eight months, and  
12 they go, of course not, no way we can do this within  
13 eight months.

14 So then the other questions are, well, could  
15 we change that result if we tinker? For example,  
16 let's fix the contract timing, would that change the  
17 result? No.

18 What if we sort of had assumptions for the  
19 one, five, and 10-year projections, would that help?  
20 No. Well, it would help, but would it change the  
21 result? Absolutely not.

22 What if we did something, we eliminated the  
23 web page? It wouldn't change the result.

24 This thing needs radical surgery and I'm  
25 going to talk about that in a minute. So because the

1 exemption doesn't really exist, at least from all the  
2 financial institutions I've talked to, that means the  
3 brokerage model is rendered effectively illegal, which  
4 means that in the fall of '16, 20 million plus small  
5 IRAs are going to be told that they can no longer have  
6 access to a financial professional. Plans are being  
7 made today, financial institutions are talking about  
8 doing that right now because this is a long, long  
9 process.

10 So what are they going to do instead? Plans  
11 are already being made that when new money comes in,  
12 those financial institutions have no choice but to  
13 work with those people on non-retirement accounts. In  
14 other words, if you tell a broker working with a small  
15 saver that it's illegal to work with them on an IRA,  
16 they have to work with them on the non-retirement  
17 accounts. And again, people are actually spending  
18 time right now looking at expanding the non-retirement  
19 side of their business, because helping small business  
20 is going to be so much harder.

21 I've already heard from at least one major  
22 company saying that they're going to withdraw.  
23 They've already made the decision they're withdrawing  
24 from the small business market. They see the  
25 handwriting on the wall.

1           Investment education programs, many are  
2 going to be eliminated. And the reason is, it's sort  
3 of very simple, in the sense that if you go to a  
4 participant and say, you should be 30 percent invested  
5 in large cap funds and large cap funds and they come  
6 back to you and say, well, I don't really know what  
7 the means, do we have any in our plan, and you say I  
8 can't tell you, that's the definition of bad employer  
9 relations. They won't do that. So they will have to  
10 just -- for those programs, they'll just get canceled.

11           And financial institutions are already  
12 telling plan sponsors that the call centers will be  
13 instructed not to answer questions about investments,  
14 not to answer questions about distributions because  
15 the line is so low for crossing into advice. You  
16 can't take the risk.

17           So why? People say, oh, they'll never walk  
18 away from the \$17 trillion in the market. It's not  
19 17. It's walking away from the small accounts where  
20 you don't make money. You make money on the larger  
21 accounts. The smaller accounts are investment in the  
22 future. If it's totally impractical to work with  
23 them, they won't work with them. Now that's very,  
24 very clear.

25           And we've even seen the UK, the UK adopted a

1 rule that has the identical effect as this rule,  
2 immediately triggered a massive exodus from the small  
3 account market. The UK has been in denial for two  
4 years. They finally admitted last week, there's a big  
5 problem and they launched a major review of the advice  
6 gap.

7 So how do you solve this problem? It's  
8 actually very straightforward. First, it's fine with  
9 the best interest standard. The second component is  
10 something has to be done about the seller's exception.

11 Under the current proposal, it is crystal clear that  
12 the following is illegal. If a small business or an  
13 individual calls someone who provides retirement  
14 services and says I'd like to interview you to provide  
15 services, that interview is a fiduciary act and it's a  
16 prohibited transaction. That is crystal clear under  
17 this proposal. So nobody who provides retirement  
18 services can interview with a small business or an  
19 individual and that is flatfooted the way the rule  
20 works. So you need -- this would be about the only  
21 business in America that can't promote its own  
22 products and services.

23 Obviously I'm sort of in favor of preserving  
24 investment education instead of really, really wiping  
25 it out as I think this would do. And we need a

1 workable prohibited transaction exemption. In other  
2 words, you don't need 40 pages. You need two rules.  
3 You need a rule that says you act in the best interest  
4 of your client, and you disclose your financial  
5 interest.

6           And that disclosure can be very simple and  
7 the simpler the better because simple is understood.  
8 I stand to earn, for example, a range of somewhere  
9 between 13 and 71 basis points on these funds that I'm  
10 recommending. If you want to know where any  
11 particular recommendation is in that range, all you do  
12 is ask me. This one is 22. That one is 68. I'll  
13 tell you exactly where it is in the range and I'll  
14 tell you why. What's wrong with a simple disclosure  
15 of financial interest?

16           Next, you need a workable transition. I  
17 mean we know, nobody can do this in eight months. I  
18 mean it's not -- you talk to people, their debate is  
19 not about eight months. They're thinking, gosh, can  
20 we do this in two years? No, no possibility. So if  
21 you really want this to work, you need a real  
22 transition period. Eight months, you know, nobody is  
23 even getting started in eight months. You're talking  
24 about three years. And we can't let sort of  
25 artificial deadlines dictate substance here. The

1 right answer here is a real transition period such as  
2 three years.

3 And I think that sort of the two other  
4 points on transition is you need to protect advice  
5 that was given before the applicability date -- I have  
6 a little trouble with that word -- and you also need  
7 to protect advice that was paid for before the  
8 applicability date.

9 Let me just turn to my last point, which is  
10 good because it's less than a minute, and that is  
11 you've got 5,000 pages of comments. I mean I was  
12 amazed as I read all of the comments, how many  
13 different issues were raised and I kept reading  
14 comments and thinking, wow, I didn't even think about  
15 that. That's a great point. You have 5,000 pages of  
16 comments. The chances of getting it all right in one  
17 final reg, infinitesimal.

18 You need to re-propose. I mean I was really  
19 disappointed that before the hearing started, before  
20 the second comment, there was an announcement, you're  
21 going straight to final. That's sort of really  
22 doesn't pay much respect to the hearing process or the  
23 second comment period process. We need to have a  
24 second, people need to have a second look at this.  
25 They need to sort of see, have a good dialogue about,

1 you know, how this comes out. So maybe three seconds  
2 over.

3 MR. HAUSER: Go right ahead.

4 MR. MASON: No, I'm done.

5 MR. HAUSER: You're done?

6 MR. MASON: That was my finale.

7 (Laughter.)

8 MR. HAUSER: All right. It was a nice  
9 flourish.

10 MR. MASON: Yeah, I have a feeling you'll  
11 have a flourish too.

12 (Laughter.)

13 MR. HAUSER: So, you know, first maybe let's  
14 start with some of the areas there appear to be  
15 agreement. You know, if I understand your comments,  
16 there is agreement, I forget the way you first put it,  
17 but it was something like, we are completely fine with  
18 the best interest standard. So we appear to have some  
19 degree of agreement that there should be a best  
20 interest standard on the broad contours of what that  
21 standard should look like and about what, I think what  
22 the carve-out should look like, and that we need a set  
23 of exemptions to permit, you know, people to move  
24 forward in a broker kind of model, as well as in an  
25 advice model. And those things we do seem to have a

1 fair measure of agreement about.

2 Many of the areas of disagreement to me seem  
3 to be operational sorts of issues, precisely the sort  
4 of thing that should be worked out as part of a notice  
5 and comment process. So, you know, what should the  
6 timing of the contract be? Did you mean, as some have  
7 asserted, to exclude rollovers from the best interest  
8 contract exemption? The answer would be no and I  
9 don't think we did, but we'll certainly make that  
10 clear in the final. Do you cover one's touting their  
11 own services as fiduciary advice? No and if there's a  
12 drafting issue there, we'll make that clear.

13 There are all those kind of normal issues.  
14 But if one starts from the premise that, you know,  
15 that this isn't kind of a normal rulemaking process  
16 where we're going to get those kind of drafting issues  
17 sorted out and we're going to have an honest debate  
18 and this is the rule, it's final, and the only issue  
19 is whether or not the industry can comply with it  
20 exactly the way it is at this exact moment with no  
21 changes, you get to a different place perhaps.

22 So, we ultimately are very interested in  
23 figuring out how to fix any operational problems. We  
24 have a set of goals that we seem to have broad  
25 agreement on. We intend to listen to everybody who

1 has given us comments. And believe me, I've made my  
2 way through a good part of those 5,000 pages of  
3 comments already. And, you know, if it turns out that  
4 we simply cannot make this thing workable without the  
5 sorts of major changes that necessitate, you know, new  
6 notice and comments, so be it. But I think to  
7 prejudge that we need a new notice and comment right  
8 now, you know, I just think it's premature.

9 But I'd like to go through a number of the  
10 assertions. First off when you say you're completely  
11 fine with the best interest standard, what do you  
12 mean? Is the best interest standard as we defined it,  
13 the prudence obligation coupled with the loyalty  
14 obligation as specified in our proposal, something you  
15 agree with?

16 MR. MASON: Do I get to ask questions about  
17 what you just said or not?

18 MR. HAUSER: You can volunteer observations.  
19 (Laughter.)

20 MR. MASON: All right. I'm going to  
21 volunteer one and then I'll answer your question. I  
22 think clarifying -- you know, a lot of the things  
23 you're talking about changing would just be at the  
24 edges. I think a critical change that you did mention  
25 is to sort of to say that promoting your own services

1 is not a fiduciary act. That would be a critical  
2 change. I think the timing of the contract and this  
3 and that, you know, I mean that's not going to change  
4 results. But that is a very -- that point you made I  
5 think is critical.

6 So sort of moving to your question, I mean,  
7 are you asking about the best interest as it's  
8 articulated in the BIC?

9 MR. HAUSER: Yes.

10 MR. MASON: Yeah. I mean, I think -- I have  
11 to say that I have talked to different people with  
12 different perspectives on that and I think there are a  
13 lot of people who are very concerned -- and you've  
14 heard this, I mean it's been raised several times --  
15 that without regard language makes people nervous that  
16 they can't consider their own compensation. They're  
17 fine with putting the client first, but they are not  
18 fine with sort of just saying I'm not going to even  
19 think about like my compensation. So I think there  
20 are a number of people in the community who have that,  
21 you've heard that, and you've indicated that you are  
22 happy to address and to clarify that point and I think  
23 that would be a good thing.

24 MR. HAUSER: So maybe let's walk through  
25 just some of the observations you made. First, in

1 terms of -- and again I guess, you know, I may look  
2 youthful, but I've been around quite awhile and I've  
3 been through enough projects at this point where, you  
4 know, I've heard that if I move forward with a  
5 particular proposal, the capital markets are going to  
6 collapse. Once I think I -- the third time I'd heard  
7 that on my first year on the job, I started to  
8 discount it a little bit. And believe me, I don't  
9 have that kind of power.

10 But when I hear that, you know, nobody in  
11 the industry is going to be able to comply with the  
12 rule --

13 MR. MASON: Nobody I spoke to.

14 MR. HAUSER: -- no one you spoke to, even as  
15 revised, I mean I have to wonder a little bit what  
16 people are being told, you know, what it is they're  
17 saying they're not going to be able to comply with.

18 For example, in your comment letter, you  
19 refer to a study by Greenwald and Associates, where  
20 Greenwald and Associates essentially, you know, did a  
21 survey, which indicated that, well, nobody was going  
22 to be able to, you know, comply with our rule and  
23 small businesses were, you know, going to stop  
24 sponsoring plans and the like. But you look at the  
25 lead-in to the survey and it describes the rule as

1 "the Department of Labor is considering prohibiting  
2 both retirement plan providers and the advisors who  
3 sell retirement plans to employers from assisting the  
4 employers in the selection and monitoring of the funds  
5 in the retirement plan." Does that not seem a little  
6 slanted?

7 MR. MASON: Let me have two answers and I  
8 apologize for having two answers. But on this sort of  
9 sky is falling point, you know, I don't know, we can  
10 compare ages, but that wouldn't be all that fun. But  
11 I've been around a few years and I do remember as I  
12 talk to people about if you do this, the defined  
13 benefit plan is going to -- our system is going to  
14 continue in decline and there was all this, yeah,  
15 yeah, I've heard this sky is falling. I think those  
16 predictions have turned out to be very, very accurate.  
17 So I think that's one important point.

18 I was so carried away, what was your --

19 MR. HAUSER: My question is it seems to  
20 me --

21 MR. MASON: I got so passionate.

22 MR. HAUSER: I know, but it seems to me when  
23 people are telling me --

24 MR. MASON: Oh, yeah, dramatic, dramatic,  
25 yeah. Yeah, I got it.

1 MR. HAUSER: -- they're not going to be able  
2 to comply, you know, when people are given a survey  
3 that says the Department of Labor is considering  
4 prohibiting both retirement plan providers --

5 MR. MASON: That's exactly how I read the  
6 proposal.

7 MR. HAUSER: That's how you read it?

8 MR. MASON: Absolutely.

9 MR. HAUSER: And can you point to any  
10 language anywhere in the proposal that prohibits  
11 advisors from providing --

12 MR. MASON: Yes, absolutely, absolutely.  
13 When you provide assistance, in other words, I have --  
14 I'm a service producer. I have 3,000 investment  
15 options. I go to that small business owner and the  
16 business owners says, look, I want to offer 10 or 15  
17 to my employees and today I can provide education to  
18 that small business owner about what other similar  
19 small businesses have done in terms of lineup. Here's  
20 a conservative lineup. Here's a more aggressive.  
21 Here's a moderate lineup. Here are the differences.  
22 Here's how you can mix or match. Your decision,  
23 that's education in my mind. It's not fiduciary  
24 advice. Very clear under this proposal that's  
25 fiduciary advice and it would be a prohibited

1 transaction because there is no exemption. So that  
2 description in the Greenwald Study, to me, is 100  
3 percent correct.

4 MR. HAUSER: Okay.

5 MR. PIACENTINI: So the implication seems to  
6 be there that there's no way to provide fiduciary  
7 service to small businesses, that nobody is doing that  
8 or maybe the companies that you spoke to don't do that  
9 in the marketplace now.

10 MR. MASON: In terms of if you're doing --  
11 the financial institutions that serve those markets  
12 today that I deal with, they are the sort of --  
13 they're the record keepers and financial institutions  
14 that have an array of different funds that they offer,  
15 some are proprietary, some are non-proprietary, but  
16 have different amounts of revenue sharing that they  
17 pay. And in that context, it's basically a  
18 prohibition.

19 MR. PIACENTINI: Leave aside the proprietary  
20 for a minute, but there's no way to level, to rebate  
21 to the sponsor --

22 MR. MASON: I mean the only way to levelize  
23 is to eliminate your revenue stream because there may  
24 be some --

25 MR. PIACENTINI: -- to rebate the revenue?

1 MR. MASON: Well, yeah, but that's  
2 eliminating your entire stream.

3 MR. PIACENTINI: No, you keep the part  
4 that's a negotiated fee. That is an existing practice  
5 in the marketplace.

6 MR. MASON: Well, no, you'd levelize, you'd  
7 have to levelize. In other words, if I keep -- so the  
8 idea is if the different funds are paying me different  
9 amounts --

10 MR. PIACENTINI: Right.

11 MR. MASON: -- I read that as a prohibited  
12 transaction and so I'd have to rebate -- I'd have to  
13 establish sort of an amount that everybody pays me and  
14 any excess I'd have to rebate to the plan.

15 MR. HAUSER: So, Mr. Mason, I mean, I think  
16 this is just an example of my concern about this kind  
17 of talk about the likely impact of our rule. I mean  
18 the fact is, you know, there's a platform provider  
19 exception that's available for the small business  
20 person. Small business person could hire, you know,  
21 an adviser on a non-conflicted basis. There's a  
22 specific provision in the regulation for a variety of  
23 education that would be treated as non-fiduciary with  
24 respect to any platform that's being provided.

25 And in the SEP and SIMPLE IRA context, any

1 advice to the individual IRA participant would be  
2 covered by the best interest contract exemption. And  
3 we specifically asked in the text of the rule whether  
4 the best interest contract exemption shouldn't be  
5 extended to the small sponsor.

6 You may think all of those things are  
7 inadequate to deliver advice. But to simply tell  
8 sponsors in a survey that, you know, the Department of  
9 Labor is thinking about prohibiting advice when it  
10 quite plainly is not what we're intending to  
11 prohibit --

12 MR. MASON: It is. No, I guess I just don't  
13 accept that in the sense that you're saying that I can  
14 go to somebody with 3,000 options and say do it  
15 yourself, here's my platform of 3,000. That's not the  
16 real world. And you're also telling me I should go to  
17 --

18 MR. HAUSER: No. Mr. Mason, I did not tell  
19 you that.

20 MR. MASON: You can call me Kent.

21 (Laughter.)

22 MR. HAUSER: Well, Kent --

23 MR. MASON: You can yell at me now.

24 MR. HAUSER: -- I didn't tell you that.  
25 That's not what I said. I gave you a variety of

1 mechanisms by which I think the advice can be  
2 delivered and also indicated, as is a fact, that we  
3 asked in the preamble whether the best interest  
4 contract exemption shouldn't be extended to small  
5 sponsors.

6           And it's just that you can kind of take this  
7 across the board. In every instance if you're going  
8 to adopt the very most unfavorable point of view from  
9 the perspective of your clients of what can be done  
10 here and if you're not going to acknowledge a  
11 willingness on the Department's part to fix  
12 operational issues and you're going to tell them  
13 that's what the rule is, that's that, and you comply  
14 or not isn't the answer --

15           MR. MASON: I'm just telling factually what  
16 the proposal does. I'm not --

17           MR. HAUSER: No, you're telling your  
18 interpretation of it and it's not even an  
19 interpretation that the Department of Labor agrees  
20 with.

21           MR. MASON: Well, I don't think that would  
22 be the standard. In other words, we are reading the  
23 proposal, okay. Once it leaves your hands, it is a  
24 proposal and sort of how you view it is not the issue.  
25 The issue is what does it say. And under it, under

1 the proposal, there is an effective prohibition on  
2 exactly what I described.

3 MR. HAUSER: Okay. Well, I just disagree.  
4 But let's walk through some of the reasons why you  
5 think the best interest contract is unusable.

6 MR. MASON: Okay.

7 MR. HAUSER: And put aside everything else  
8 in the best interest contract exemption, I want to go  
9 piece by piece and you tell me which item as I go  
10 through them you think is going to be unusable for a  
11 broker.

12 MR. MASON: How are we doing on time?

13 MR. HAUSER: Let's start with a binding  
14 commitment, a binding up front commitment to act in  
15 your customer's best interest. We'll use the ERISA  
16 prudence and loyalty definition, so we'll take away  
17 that without regard to. Do you think the exemption is  
18 unusable if we ask brokers and their employing firms  
19 to do that much?

20 MR. MASON: To just have a sort of a  
21 unilateral contract, for example.

22 MR. HAUSER: Okay. We can do it by --

23 MR. MASON: An enforceable agreement.

24 MR. HAUSER: An enforceable agreement.

25 That's --

1           MR. MASON: I mean, just -- I'll be very  
2 frank here, in terms of the financial institutions  
3 that I've talked to, there is a difference of opinion  
4 on that point. Some say they can live with that  
5 contract. Others say that contract poses far too much  
6 liability in terms of state law class action. So  
7 that's -- you know, all I can do is answer sort of as  
8 accurately as I can about the different views that I  
9 hear within the community.

10           MR. HAUSER: And what you're hearing from  
11 the community is even in just merely committing up  
12 front an enforceable manner to adhere to a best  
13 interest standard is enough to make people exit?

14           MR. MASON: No, that's not -- no, it's under  
15 a contract that can be enforced pursuant to state law  
16 class actions. In other words, committing to a best  
17 interest does not mean sort of having this contract.  
18 There are other ways to commit to a best interest  
19 without having a contract enforceable under state law  
20 class actions.

21           MR. HAUSER: And what would be the other  
22 enforceable ways?

23           MR. MASON: The simple way -- and again I'm  
24 saying there's different views within the community.  
25 I'm not trying to say, you know, everybody is on the

1 same page on this like they are on most of the things  
2 I mentioned. But I think the alternative is to say  
3 this is a condition of the exemption. Acting in your  
4 best interest is a condition of the exemption. Now  
5 that's the alternative.

6 MR. HAUSER: And so sticking with the  
7 contract and this reluctance -- the possible exit from  
8 the market is true even if we retain the binding  
9 arbitration for individual claims? Just the  
10 possibility of class action claims is enough to let  
11 people run away?

12 MR. MASON: That is what I've heard from  
13 some companies, yes, absolutely. And, you know, as I  
14 say, that's not the universal view from the companies,  
15 but it is not an -- it's not by any means an  
16 insignificant portion and I don't have any great feel  
17 for sort of the size of the different groups.

18 MR. HAUSER: So it seems to me that, I mean,  
19 what that would be saying is that, you know, folks in  
20 this marketplace are prepared to tell their customers  
21 that they're adhering to a best interest standard and  
22 that they're acting in their customer's best interest,  
23 because that is what they do, but not if it's going to  
24 be enforceable by the customer.

25 MR. MASON: There's a lot of -- I think, as

1 I say, some are worried about state law class actions  
2 and are just being held up by those things, yes.

3 MR. HAUSER: And then I guess among the  
4 people you're talking to, if I go that extra step  
5 beyond just the best interest contract and I say, and  
6 you should also have policies and procedures to  
7 ensure, to reasonably ensure that people are going to  
8 comply with that and you don't incentivize people to  
9 violate the contract, does that pretty much put  
10 everybody out in your conversations?

11 MR. MASON: Is that a leading question?

12 MR. HAUSER: Yeah, I think it was.

13 MR. MASON: I think the answer here is --  
14 the question is, you know, should you have incentives  
15 that cause you to violate the best interest? No. But  
16 I think the way it was sort of structured under the  
17 proposal was to say, you better have some darn good  
18 reasons not to have level pay at the advisor level and  
19 I do sense that there is very, very significant  
20 concern about that point.

21 You know, for example, and I think you're  
22 going to hear about this from some of my friends on  
23 the next panel, in the annuity context, you know, you  
24 did in the preamble sort of I think have an  
25 appropriate nod to the fact that some investments take

1 more time and expertise to sell and that might justify  
2 a higher sort of fee at the advisory level. The  
3 problem is if you're risking a massive amount of legal  
4 liability, how do I determine sort of which -- you  
5 know, how to set that additional amount.

6 Nobody has a clue how to set that additional  
7 amount based on some nebulous concept of more time and  
8 expertise. So that risk of sort of just totally  
9 shooting in the dark as to what the differential could  
10 be is a huge problem, huge problem and really a deal  
11 killer for a lot of people.

12 And so do we have a problem sort of talking  
13 about, you know, don't have incentives to violate  
14 their best interest? Not a problem. But when you  
15 translate that into level fee at the advisory level  
16 with these squishy exceptions that really nobody would  
17 have any certainty they would meet, that's a problem.

18 It's a big problem.

19 MR. HAUSER: Well, again, and this is part  
20 of how I think the notice and comment process is  
21 supposed to work, you know, we indicated in the  
22 preamble to the exemption certainly one way for a  
23 financial institution to comply is to adopt a level  
24 fee structure, but the exemption does not mandate such  
25 a structure. And then we go on later to say, you

1 know, after giving these various examples, they're not  
2 exhaustive. Many other compensation and employment  
3 arrangements may satisfy the contractual warranties.  
4 The exemption imposes a broad standard for the  
5 warranty and policies and procedure requirement, not  
6 an inflexible and highly prescriptive set of rules.  
7 The financial institution retains the latitude  
8 necessary to design its compensation employment  
9 arrangements provided that those arrangements promote  
10 rather than undermine the best interest and impartial  
11 conduct standards.

12 That's clearly what was intended. We're  
13 clearly inviting comments and proposals from people on  
14 how to implement that. And if there are other  
15 examples -- if the five examples we gave, you know,  
16 aren't sufficient, we're asking people for additional  
17 guidance. There's not a level fee requirement in  
18 here.

19 MR. MASON: I think the point here is  
20 there's a safe -- I think the way it's read is that  
21 there's a safe harbor if you have a level fee and you  
22 stray outside that safe harbor at your own peril and  
23 people are not into their own peril. But I think the  
24 point that you're making about, you know, how can we  
25 work with you to create alternative, you know, ways to

1       comply is a fair one and we should get back to you  
2       with answers on that point.

3               MR. HAUSER: With comments.

4               MR. MASON: Absolutely.

5               MR. HAUSER: With comment letters.

6               MR. MASON: Absolutely.

7               MR. HAUSER: That would be the -- that's the  
8       way we work with each other in this process. And I  
9       mean just continuing on with some of the other  
10      assertions and then, again, I mean if you think about  
11      it for a minute, I really wasn't trying to be flippant  
12      at the start. I mean I know that there are legitimate  
13      concerns out there about how to operationalize this  
14      and we're dead set on dealing with those concerns.  
15      But to come in and to say that nobody is going to do  
16      this and you know this for a fact because you've  
17      talked to all these folks, you know, the reality is if  
18      you agreed with our economic analysis, which I don't  
19      think you do, but if you agreed with it, if you  
20      thought we would right about it, you know, what we  
21      think is there is in excess of \$17 billion a year  
22      transfer essentially going from, you know, from the  
23      investors to the financial services industry.

24              Now if you ask me how likely it is -- just  
25      knowing that fact, that the financial services

1 industry is going to think a proposal that cuts into  
2 that is something they should endorse, I would think,  
3 well, probably they're not going to love it. And, you  
4 know, and similarly if my experience over the years  
5 has been any time we've proposed expanding someone's  
6 fiduciary duties, even if they're people who, you  
7 know, in all earnest think they're acting as  
8 fiduciaries, they tend to resist the imposition of  
9 liability. That's the natural order of things, you  
10 know. But it shouldn't be an indicator of whether or  
11 not we can get to a rule that we can all work with.

12 MR. MASON: And I'm not disagreeing that we  
13 can get to a rule. In other words, that's why I sort  
14 of went through sort of something which I think meets  
15 your objectives, but is a workable thing for the  
16 industry so that you don't have people losing access  
17 to information, which is what I think would happen.  
18 And, you know, with respect to Joe, I do, we would  
19 strongly, you know, for reasons articulated, we don't  
20 agree with the 17 billion.

21 MR. HAUSER: I thought that was true.

22 MR. MASON: I just figured, you know, why  
23 not.

24 MR. PIACENTINI: For the record that's the  
25 CEA's number, but we like those --

1 MR. MASON: No, I understand, I understand.

2 No, I get it.

3 MR. HAUSER: And similarly there's -- and,  
4 again, I mean I would invite, you know, you in  
5 particular, but anybody else who wants to make  
6 comments, there's a number of points in your document  
7 here, you say, we would say even casual comments and  
8 casual conversations about investments would be picked  
9 up as fiduciary, when in fact, you know, we have a  
10 lengthy education provision that specifically provides  
11 that you can talk in detail about the specific  
12 investments, what their performance has been, their  
13 history --

14 MR. MASON: Can I give you a hypo? Can I  
15 give you a hypo?

16 MR. HAUSER: Well, can I just finish,  
17 please.

18 MR. MASON: Oh, absolutely, sorry.

19 MR. HAUSER: Thank you. You know, all of  
20 these things and the expense associated with the  
21 contract, the distribution options, all of the details  
22 of it, we specifically -- and this is additional, this  
23 is new in this proposal, we specifically include as  
24 education information, you know, about the advantages,  
25 you know, of keeping the money in the plan, about the

1 retirement sorts of information. And we tried very  
2 hard to, you know, define the trigger for fiduciary  
3 advice in the first place in a way that's aligned with  
4 the FINRA standard, a recommendation, a call to  
5 action. That's not a casual conversation.

6 But I fear if that's what people are hearing  
7 from you, if that's what you're telling them, of  
8 course they're going to say, well, we don't like this  
9 rule. But it's not really what we've said here, is  
10 it?

11 MR. MASON: I mean first of all, there's  
12 sort of this thing, okay, they're hearing it from me.  
13 You're overstating sort of my effect by sort of  
14 thousandfold. You didn't get 5,000 pages of sort of  
15 comments because sort of I thought, well, gee,  
16 everybody, let's all comment on this proposal. You  
17 got 5,000 pages because there's a sort of an enormous  
18 level of concern. And in terms of sort of -- you  
19 know, I'd be very interested, and I'm saying this in  
20 all sincerity, because, you know, plan sponsor people  
21 call and say, you know, I look at this and I'm just  
22 thinking about our HR person and somebody wanders into  
23 the HR office and says, hey --

24 (Timer chimes.)

25 MR. MASON: Can I keep my hey going?

1 MR. HAUSER: Yes.

2 MR. MASON: Okay. So wanders into the HR  
3 office and says, look, I spent a lot of time on  
4 picking out my funds, can you just take a look at it.

5 I don't really know what I'm doing, but does this  
6 look like what -- does this lineup look like something  
7 that I should be doing or am I just way off base. And  
8 the HR person says, look, I'm not an expert, but  
9 that's very similar to what other people, sort of  
10 similar situated people are doing.

11 That sounds like a suggestion, like this is  
12 okay about a very specific set of investment patterns  
13 and I don't see anything that carves that out --

14 MR. HAUSER: Yeah, there is.

15 MS. RITTENHOUSE: Yeah, there is.

16 MS. MCBRIDE: Yeah, there is.

17 MR. HAUSER: There's a specific provision on  
18 the HR --

19 MR. MASON: No, it is not. No, it doesn't.

20 MS. MCBRIDE: It's very specific.

21 MR. MASON: No, it doesn't. Actually that's  
22 wrong, that's wrong.

23 MR. HAUSER: So if you think --

24 MS. RITTENHOUSE: It's in there.

25 MR. MASON: No, it's not.

1 MS. MCBRIDE: If you read it, it's in there.

2 MR. MASON: No, it's advice to the  
3 fiduciary. This is advice to a participant, so that's  
4 wrong. I am right about this and I'll read it to you.

5 MR. HAUSER: No, Kent, Kent, it's fine.  
6 There are two ways in which what you're saying in  
7 incorrect. I mean, first off, again, this is an  
8 example, if you think we need to say more about that  
9 HR person and that limiting it to the fiduciary isn't  
10 enough, that's what the comment process is for.

11 But I'm going to say, the other thing as a  
12 general proposition is, you're not going to be adviser  
13 -- you have to be an adviser for a fee. There has to  
14 be a fee --

15 MR. MASON: HR people get paid. HR people  
16 get paid to help --

17 MS. MCBRIDE: Paid for that service.

18 MR. MASON: No, that's not true.

19 MS. MCBRIDE: No, it's in there.

20 MR. MASON: That's not true. That's not  
21 true.

22 MR. HAUSER: I mean, I can tell you, we  
23 would not construe that to be an investment --

24 MR. MASON: If you said that formally, that  
25 would make a huge difference.

1 MS. MCBRIDE: It's explicitly in there.

2 MR. MASON: It's not in there.

3 MS. MCBRIDE: It is.

4 (Laughter.)

5 MS. MCBRIDE: Sorry.

6 MR. HAUSER: But regardless, the point is  
7 there are all these different -- you know, there are  
8 bound to be a number of interpretive issues. But  
9 assuming that each one is going to go the worst way  
10 possible for your point of --

11 MR. MASON: I'm just --

12 MR. HAUSER: -- you know, view and -- well,  
13 I'll just leave it.

14 MR. PIACENTINI: So I know we're out of  
15 time. Let me just say that I was actually  
16 disappointed that you or somebody who worked on the  
17 different reports that you submitted didn't ask to  
18 testify at the part of the hearing on the economic  
19 analysis.

20 MR. MASON: Yeah.

21 MR. PIACENTINI: I do appreciate you  
22 bringing to the table, you know, your survey findings  
23 and so forth. You know, we welcome any and all kinds  
24 of input.

25 MR. MASON: Yeah. You know, that's a fair

1 point, Joe. I mean --

2 MR. PIACENTINI: As you might expect, I do  
3 have questions I would have liked to ask about what's  
4 behind some of those findings, what some of the  
5 methods are. It would be helpful --

6 MR. MASON: I mean, if you would like to  
7 have follow-up, I mean, it really was sort of, you  
8 know, just a combination of sort of timing factors, et  
9 cetera, as opposed to any, you know, just working  
10 on -- the tight time sort of between all these things.

11 MR. PIACENTINI: Sure, understood.

12 MR. MASON: So I think it's a very fair  
13 point, Joe, and I would like to have the opportunity  
14 to sort of have that dialogue with you.

15 MR. PIACENTINI: And just to offer just one  
16 example, so you have a sense of the kind --

17 MR. MASON: Okay.

18 MR. PIACENTINI: -- of questions that will  
19 be on my mind. With respect to both small employers  
20 and whether they sponsor plans and individuals and how  
21 much they save, your reports reference a lot, that you  
22 tend to see that the presence of a financial advisor  
23 when you see plan sponsorship and greater savings, and  
24 it seems to attribute all of that to, well, the  
25 advisor's presence causes this. Of course we also

1 have research that show that people who tend to save  
2 more, have more money are more than likely to see an  
3 advisor.

4 It didn't appear, although it didn't say for  
5 sure one way or the other, but it didn't appear that  
6 the report make any adjustment for that when it then  
7 tried to project what would happen if there was less  
8 access to advice. So that's the kind of question that  
9 I would want to ask.

10 MR. MASON: And we'd love to have that  
11 dialogue with you, Joe.

12 MR. PIACENTINI: Okay, all right. Thanks.

13 MR. HAUSER: Thank you all very much.

14 (Panel switch.)

15 MR. HAUSER: So this is the last panel of  
16 the day I think, yes? Okay. So we went a little  
17 over, but you can do likewise. So if you are all  
18 settled --

19 MR. HADLEY: Thanks so much for having us  
20 here. We're pleased to be here to testify regarding  
21 this important proposal. My name is Mike Hadley and  
22 here with me is my partner, Joe McKeever. We might as  
23 well get it out there, we are Kent's partners. Our  
24 firm represents the Committee of Annuity Insurers, a  
25 coalition of life insurance companies that was

1       formed --

2                   MR. HAUSER: That's not personal.

3                   (Laughter.)

4                   MR. HADLEY: I know it isn't and we  
5       appreciate that. The Coalition was formed in '81 to  
6       represent the interest of the annuity business and  
7       participate in the development of federal policy with  
8       respect to annuities, representing about 80 percent of  
9       the annuity business in the U.S.

10                   The vast majority of savers in DC plans  
11       don't have access to a product that can generate  
12       guaranteed income in retirement and we strongly  
13       supported the efforts that you and the Treasury  
14       Department haven taken to try to increase the  
15       availability and use of annuities and plans. But for  
16       most participants, the only means to obtain guaranteed  
17       lifetime income is through a rollover into an IRA  
18       annuity. And if the proposal essentially prevents an  
19       agent, broker, or insurance company from being able to  
20       sell and explain an annuity without taking on  
21       fiduciary obligations and costs, annuities outside of  
22       plans would be less available and cost more when  
23       offered and that means less guaranteed income in  
24       retirement.

25                   We certainly don't want to see this result

1 and we really don't believe that you want to either.  
2 As a result, we want to work with you to ensure the  
3 important protections and guarantees that annuities  
4 provide will continue to be available to savers, while  
5 still achieving our shared goal of ensuring the  
6 financial professionals who provide investment advice  
7 act in the best interest of their clients.

8 Before I highlight some of the  
9 recommendations we made in our comment letter, to  
10 avoid unintended consequences, let me offer a few  
11 comments regarding annuities that are used in  
12 qualified plans and IRAs. And you heard some of this  
13 earlier, so apologies for me saying it again.

14 First, annuities are not simply investments.  
15 All annuities, both those that are securities and  
16 those that are not securities, provide insurance  
17 protection guarantees against longevity and other  
18 risks by allowing individuals to transfer those risks  
19 to an insurance company.

20 Second, while the cost of an annuity  
21 contract will often be greater than the cost of  
22 purchasing an indexed fund, those costs reflect the  
23 cost to the insurance company providing the benefits  
24 its guaranteed to its policyholders, benefits that  
25 often will not be paid until many years in the future.

1       And the costs reflect the time and effort that must  
2       be invested by someone in developing and understanding  
3       both the annuity product that they offer and the needs  
4       of the particular consumer with whom they're  
5       interacting.

6               Third, annuities and those who sell them are  
7       heavily regulated. We recognize there have been  
8       instances in which the purchase of an annuity has not  
9       turned out well for the purchaser. As an industry, we  
10      want to avoid any bad outcome involving an annuity  
11      contract. But such outcomes are no more common with  
12      annuities than with other investments.

13             For example, if you look at the types of  
14      securities involved in arbitration cases with FINRA in  
15      2014, parties indicated annuities were involved in  
16      about 113 cases and variable annuities were involved  
17      in about 120 cases. In comparison, they indicated  
18      that mutual funds were involved in 378 cases and the  
19      various forms of individual stocks or bonds were  
20      involved in 716. Now we'd like that number to be zero  
21      obviously.

22             But we hear about these cases in no small  
23      part precisely because state insurance regulators and  
24      self-regulatory organizations like FINRA have  
25      procedures to protect customers. And so for the same

1 reason we'd like you to never put out a press release  
2 about an enforcement action, those press releases are  
3 there because you're on the case.

4           Again, we don't think you intended to limit  
5 access to the guaranteed income that annuities  
6 provide, but we fear that without revisions the  
7 proposal will have that result. So I'm going to turn  
8 to discuss some of the recommendations we made in our  
9 comment later, although because of time constraints  
10 obviously I can't address every comment.

11           Let's start with the sellers carve-out. We  
12 agree with the Department's statement that the  
13 proposal should not cover incidental advice as part of  
14 an arm's-length transaction with no expectation of  
15 trust or acting in the customer's best interest. And  
16 so we strongly recommend that the sellers carve-out  
17 not be limited to fiduciaries of large plans, but  
18 rather be available in appropriate circumstances for  
19 discussions with all plan fiduciaries, participants,  
20 and IRA owners. And we understand your concern that  
21 in the context of a sale of an annuity, discussions  
22 about the sale should not be presented as unbiased  
23 advice.

24           Now the sellers carve-out comes with very  
25 detailed conditions to ensure that there is no

1 confusion that the person is acting as a seller and  
2 not providing unbiased advice. To take advantage of  
3 the sellers exception, you have to obtain a written  
4 representation the person will not rely on you to act  
5 in their best interest or as a fiduciary. You've got  
6 to inform the person of the existence and nature of  
7 any financial interest. You've got to receive a  
8 written representation the person had sufficient  
9 expertise to evaluate the transaction and to determine  
10 whether the transaction is prudent. And you can't  
11 receive a fee for providing investment advice. If  
12 those conditions are satisfied whether the person is a  
13 plan fiduciary, participant, or IRA owner, it's hard  
14 to see how any adult human being would be confused  
15 that they're expecting unbiased investment advice.

16 Let me now turn to PTE 84-24. We agree with  
17 the Department that a workable principle-based  
18 exemption is critical. We have a number of pretty  
19 serious concerns about BICE, which you've heard about,  
20 and which we detail in our comment letter. We'd be  
21 happy to answer any questions. And we have a  
22 straightforward solution that's consistent with the  
23 Department's goals.

24 PTE 84-24 should continue to be the  
25 exemption applicable to all annuities and other

1 insurance projects. The notion of variable annuities  
2 are the same as mutual funds misunderstands that all  
3 annuities are designed to and in fact do provide  
4 insurance protection against longevity risk by pooling  
5 the risk among the large group of individuals so no  
6 single individual bears the risk alone. Annuities  
7 that are securities under the Federal Securities laws  
8 and those that are not all have advantages and  
9 disadvantages. None is inherently better than the  
10 other and none should be chose based on which PTE  
11 applies.

12 I do want to be clear, our concern about the  
13 distinction you've proposed between different types of  
14 annuities doesn't mean all annuities should be forced  
15 into the best interest contract exemption. For a  
16 variety of reasons, which you mentioned yourself in  
17 the preamble, the best interest contract exemption is  
18 not suited for annuities. Nonetheless, if you want to  
19 keep variable annuities and IRAs in the best interest  
20 contract exemption, this single exemption should  
21 consist of simplified conditions based on the  
22 straightforward and workable conditions in 84-24, as  
23 you've propose to amend.

24 So let me just say that again, if variable  
25 annuities remain in the best interest contract

1 exemption, should be based on three straightforward  
2 and appropriate conditions that you've added to 84-24.

3 The advisor acts in the client's best interest, the  
4 advisor makes no misleading statements regarding the  
5 products or its fees, and the advisor discloses their  
6 material conflicts of interest. Most of the other  
7 conditions in BICE are unnecessary, particularly in  
8 light of the existing regulatory structure and  
9 disclosures that are already required by the SEC and  
10 FINRA.

11 Our comment letter also makes some important  
12 recommendations for further changes to 84-24. For  
13 example, it's critical you confirm that 84-24 provides  
14 relief for the purchase of an insurance company's own  
15 product, if the insurance becomes a fiduciary and  
16 covers the compensation inherent in the contract  
17 itself. Second, that you expand the types of  
18 compensation beyond insurance commissions. Third,  
19 that you clarify that the best interest standard based  
20 -- that you've heard this discussion about the  
21 "without regard to."

22 Let me just talk a little bit about  
23 education focusing on the concerns we have for the  
24 sale of annuities -- the use of annuities, I'm sorry.

25 When you're providing education to the owner of an

1 IRA annuity, somebody who already owns it, they're  
2 always going to have the option to annuitize their  
3 contract and they may have other options available  
4 under the contract. Those options have to be  
5 explained and the pros and cons of those also have to  
6 be explained and we appreciate your saying in these  
7 hearings that explaining the features of the product  
8 is still education.

9           Likewise, if a plan offers an annuity  
10 distribution option, that option has to be explained  
11 to the participant and we appreciate again what I  
12 think you've said that you didn't intend to cut that  
13 out of education. It's really not conceivable that  
14 you could be educated without mentioning the product,  
15 particularly a product you already own.

16           Let me close by making the self-evident  
17 point that no DOL regulation in a generation is more  
18 complex or affects more savers or more industry  
19 participants. We believe the industry is going to  
20 take -- they're going to need three years to implement  
21 the changes necessary and we strongly urge the  
22 Department to provide the proposal does not apply to  
23 annuities sold prior to the effective date of the  
24 regulation. This regulation obviously wasn't priced  
25 into the sale of that product.

1           Also, I want to reiterate that again what  
2 I've said a couple of times, we don't believe the  
3 Department intends to cut off access to guaranteed  
4 income. In fact, throughout this administration  
5 you've done a number of things to actually encourage  
6 that and I want to thank you again for those actions.

7       We want to make sure that the current proposal does  
8 not contribute to the decline of retirement security  
9 that life annuity payments can provide, and we believe  
10 with some changes, to clarify the fiduciary test and  
11 to make those exemptions effective, we can meet our  
12 shared goal of helping Americans be more secure in  
13 their retirement.

14           Thanks and we'd be happy to take any of your  
15 questions.

16           MR. HAUSER: Thank you.

17           MR. MURPHY: Good afternoon. My name is Ed  
18 Murphy and I'm President of Empowerment Retirement.  
19 We're the second largest retirement recordkeeping in  
20 the United States with about seven-and-a-half million  
21 participants. And I appreciate the opportunity to  
22 testify. And I hope today to suggest some ways the  
23 proposed rule could be amended to promote greater  
24 clarity and remove some ambiguity.

25           I'd like to begin by sharing some results

1 from our research efforts. Empower's research shows  
2 access to guidance makes a major positive contribution  
3 to reaching one's retirement goals. Each year our  
4 research and education arm, Empower Institute,  
5 conducts a comprehensive survey of working Americans  
6 retirement readiness or what we call lifetime income  
7 score. It's basically defined as the participant's  
8 ability to replace varying percentages of their  
9 working income for life.

10           The survey takes account of projected Social  
11 Security benefits, home equity, even business  
12 ownership. It's very comprehensive. It further  
13 amasses the importance of multiple variables, such as  
14 access to workplace savings, home ownership, and  
15 levels of savings. We have consistently found that  
16 one of the most important such variables is access to  
17 professional investment advice. In fact the impact is  
18 dramatic. Working Americans who draw on professional  
19 financial advice regardless of their income levels are  
20 on track to replace 30 percent more of their working  
21 income for life than those who lack such advice. This  
22 suggests to us that any policy change that expands  
23 access to advice is positive and anything that  
24 inhibits access to advice risks undercutting working  
25 people's retirement future.

1           Our experience further shows that guidance  
2           is also invaluable when a workplace saver actually  
3           retires and needs to draw down their savings for  
4           income. Helping participants understand the  
5           distribution options available to them and the  
6           potential consequences of choosing among those options  
7           is critical in limiting the leakage of retirement  
8           savings.

9           For example, data from the plans that  
10          Empower record keeps shows an 18 percent decrease in  
11          participants who cash out their distributions when  
12          they're given the opportunity to speak with one of our  
13          call center representatives. Empower representatives  
14          field over four million calls a year -- that's 16,000  
15          calls every working day -- and those workplace savers  
16          seek information on a range of issues, including  
17          roughly seven percent inquiring about investments in  
18          the plan's fund lineup, 26 percent asking for  
19          information on options for distribution, 22 percent  
20          asking for ways to access their savings while they're  
21          still working and contributing to their plans.  
22          Answering these requests is a major part of the value  
23          we deliver to plans and to workplace savers.

24          We are naturally concerned then about the  
25          scope and the breadth of the proposed rule definition

1 of what constitutes advice. It would include any  
2 communication that based on content, context, and  
3 presentation might reasonably be viewed as a  
4 suggestion to engage or refrain from taking a  
5 particular course of action. We believe this is too  
6 broad. It could inadvertently cause many  
7 conversations regarding elements of a participant's  
8 plan to be deemed fiduciary advice including such  
9 generic information as the availability of managed  
10 accounts or the discussion of rollover options.

11 A more appropriate definition would limit  
12 the definition of fiduciary advice to active advocacy,  
13 to either take or refrain from taking a particular  
14 action. General information offered without active  
15 individualized advocacy to act or not act should be  
16 excluded from the definition of fiduciary advice.

17 We're also concerned that the proposal would  
18 include communication specifically directed to an  
19 individual. As mentioned earlier we have four million  
20 conversations a year. Each and every one of those  
21 conversations is specifically directed to the party on  
22 the other end of the phone. We also often provide  
23 targeted communications, to provide categories of plan  
24 participants.

25 For example, within the same plan a

1 participant who is 90 percent invested in employer  
2 stock, they may receive a flyer detailing the risk of  
3 over concentration in a specific security and the  
4 benefits of diversification. Another participant who  
5 has reached retirement age may receive a flyer  
6 detailing distribution strategies. Similarly,  
7 participants using our website are routinely prompted  
8 to see a next best step to help them reach their  
9 retirement goals. This may be a suggestion, for  
10 instance, to raise their savings rate or perhaps  
11 change their asset allocation.

12           Clearly, there should be no expectation of a  
13 fiduciary relationships in these categorical  
14 information notices, but the proposal could make  
15 sending such information a trigger for fiduciary  
16 status. To avoid inhibiting this routine information,  
17 we suggest that the Department revise any final rule  
18 to replace the term "specifically directed" with  
19 "individualized to the recipient."

20           The proposal does include a number of carve-  
21 outs to the rule, which we believe could be further  
22 improved. In the sellers carve-out, the Department  
23 excludes the definition arm's-length selling  
24 activities, but limits this carve-out to plans of  
25 either 100 or more participants or at least 100

1 million in plan assets. The fact is that in the small  
2 business market, the fiduciary is typically the  
3 company owner, who is experienced in both buying and  
4 selling services.

5 What's more, plan sponsors are fiduciaries  
6 regardless of their size. They're all subject to  
7 requirements of ERISA. The Department's concern with  
8 small employers lacking familiarity with the different  
9 compensation structures could be addressed by  
10 including a cigarette-style warning to the employer  
11 advising them of potential conflicts and directing  
12 them to the plan sponsor level fee disclosure required  
13 under Section 408(b)(2).

14 Both the platform and monitoring carve-outs  
15 should also be expanded. This rule should make clear  
16 that creating products in which a limited number of  
17 investment options are made available is not a  
18 fiduciary act, and some of these were covered in the  
19 last session. To avoid what otherwise would be an  
20 overwhelming array of choices, Empower and other  
21 platform providers narrow the universe of thousands of  
22 investment offerings to a manageable few based on  
23 factors specific to a market segment or to a group of  
24 plans. Such decisions about what investments to offer  
25 are not however individualized to any plans and so

1 should not be considered as fiduciary acts.

2 The selection and monitoring carve-outs  
3 allows identifying investment alternatives that meet  
4 objective criteria set by the plan fiduciary. We  
5 request clarification that the service provider be  
6 permitted to assist a plan sponsor in shaping the  
7 criteria for investment options without triggering  
8 fiduciary responsibility.

9 In general, the education carve-out in the  
10 proposed rule should be expanded so that offering  
11 common planning tools does not become a fiduciary act.

12 It's commonplace, for example, both in the enrollment  
13 process and in everyday interaction for web usage and  
14 call center interactions, to illustrate possible next  
15 steps for participants. We recommend these specific  
16 expansions to the education carve-out:

17 One, stipulate that providing calculators  
18 and modeling tools that include reference to specific  
19 funds in the plan lineup is not a fiduciary act.

20 Two, clarify that providing helpful  
21 information for participants to act upon that enhances  
22 retirement readiness is not a fiduciary activity.

23 Validate that providing instructions of  
24 alternate scenarios for participants to view as a  
25 means to encourage retirement savings is not a

1 fiduciary act. This would include tools such as a  
2 lifetime income score or tools that compare  
3 participants with others in their peer group, so they  
4 can see how they're saving relative to peers.

5 We all ultimately want the same thing, a  
6 healthy retirement system that makes it easy for  
7 participants to succeed and reach their retirement  
8 dreams. At Empower, our clients are why we're in  
9 business. We take very seriously our commitments to  
10 the plans we serve and their participants. We all  
11 want to end up in the same place, but how we get there  
12 matters.

13 Thank you.

14 MR. HAUSER: Thank you. Mr. Bortz?

15 MR. BORTZ: Thank you. I'm Jason Bortz.  
16 I'm an attorney with the Capital Group. Capital is  
17 probably best known for the American Funds family of  
18 mutual funds.

19 The American Funds are only available to  
20 retail investors who work with a financial advisor,  
21 either a Registered Investment Adviser or a registered  
22 rep of a broker-dealer. And arguably the biggest  
23 change under this rule would be to make registered  
24 reps of broker-dealers into fiduciaries when they make  
25 investment-related recommendations to IRAs, right?

1           We really appreciate the proposed best  
2 interest contract exemption, the creation of a route  
3 to preserve the broker-dealer business model. We  
4 really believe that registered reps provide valuable  
5 financial advice and improve outcomes for savers. And  
6 we're broadly aligned on the best interest contract  
7 exemption you proposed. We support, like others, a  
8 best interest standard of conduct. We're also  
9 comfortable with up front disclosure, some right of  
10 recourse against an advisor who doesn't live up to the  
11 best interest standard, and some kind of conflicts  
12 mitigation, right? I think in broad brush strokes,  
13 there's some logic here, right, but it's really  
14 important to get the details right, right?

15           The top 30 financial intermediaries who we  
16 work with all have the capacity to do either  
17 commissionable business or fee-based advisory  
18 business. If you don't strike the balance just right,  
19 it's going to be much easier to do entirely and solely  
20 fee-based business and we're going to lose the  
21 valuable benefits you get from commissionable  
22 compensation structures. So we think you really need  
23 to get the details right or small balance investors  
24 are going to lose access to advice and other folks are  
25 going to end up paying more as they move to fee-based

1 programs, right?

2           You've heard lots of suggestions from others  
3 about how to improve the best interest contract  
4 exemption. We're broadly aligned with a lot of those  
5 suggestions and kind of rather than going over this  
6 trod ground, I thought instead we'd talk a little bit  
7 about transition, right?

8           We're going to move from a current world of  
9 commissionable investments to a fiduciary world,  
10 right. How are we going to get there? How are we  
11 going to transition, right? And there are really one  
12 two options under the reg going forward for existing  
13 relationships and existing commissionable accounts.  
14 You either comply with the best interest contract or  
15 you shift the client to a fee-based advisory program.

16       There's only two options.

17           Eight months to develop all of the  
18 procedural requirements and do everything that you  
19 need to comply with the best interest contract  
20 exemption, it's just not going to happen, right. It's  
21 not going to be a viable route for all of those  
22 existing accounts. You have to be ready to take a  
23 call from an existing investor who wants to know if  
24 they should hold in a downturn. Under this proposal  
25 you couldn't give them a hold recommendation unless

1 you gotten the best interest contract exemption in  
2 place or you shifted to a fee-based program, right?  
3 So eight months, there's no way that's workable,  
4 right. We need more time for that to be a viable  
5 route to meaningfully preserve the broker-dealer  
6 business model.

7           And I think we suggest in our comment letter  
8 a phase-in of the requirements. You know, you could  
9 easily start with a best interest standard out of the  
10 gate and phase in these other requirements, whether  
11 it's the right of recourse, whether it's disclosure  
12 that may take a long time to build. This is pretty  
13 kind of novel sort of disclosure stuff that you all  
14 are talking about, so I think we need a phase-in of  
15 the requirements.

16           The other thing we're going to need is clear  
17 guidance about existing accounts, right, and there are  
18 really two aspects of existing accounts, right? One,  
19 even if you get the BIC, the best interest contract  
20 exemption, exactly right, you're still going to see  
21 the shift to fee-based accounts. Lots of  
22 commissionable accounts are still going to be moved to  
23 fee-based accounts. There will be firms that are just  
24 going to say, hey, from a business perspective, I  
25 don't want to run my advisory program through

1 something the Department of Labor is calling a  
2 conflicted advice regime. I don't want to comply with  
3 this exemption. So we need guidance on what standard  
4 governs this shift from commissionable accounts to  
5 fee-based accounts.

6 So under the proposal, it will clearly be a  
7 fiduciary recommendation. The recommendation of my  
8 own fee-based program is fiduciary advice and you'd  
9 have to run it through the best interest contract  
10 exemption to deal with that conflict of interest,  
11 where you compare the revenue to the firm, the  
12 financial firm, under the commissionable program to  
13 the revenue under the fee-based program. You'd have  
14 to run it through that best interest contract  
15 exemption.

16 Now if you're going to move, as I think  
17 you've alluded to a couple of times now, away from  
18 treating the selling of your own advisory services as  
19 a fiduciary act, then you need to address how do I  
20 deal with a mixed selling of services and a sell  
21 recommendation on existing investments, right? So if  
22 you say, hey, move out of this commissionable account,  
23 come to this fee-based account, there's a mixed  
24 selling of services and a sell recommendation, which  
25 ordinarily would be contingent fiduciary

1 recommendations, right? So we need a workable best  
2 interest contract exemption for those transitions,  
3 right. You don't want to lock people in to existing  
4 investments. There needs to be a way to move from  
5 existing commissionable accounts to new fee-based  
6 programs.

7           So if you think about the best interest  
8 contract exemption, it needs to cover services, right.  
9 The disclosure needs to work for a comparison of two  
10 service programs, right, instead of being asset  
11 focused. So you need to tailor it to this kind of a  
12 transition because it's going to happen.

13           The other thing we need is a grandfather  
14 rule for hold recommendations. You know, one of the  
15 core challenges here is you've got to comply with one  
16 of these two paths, best interest contract exemption  
17 or advisory, fee-based advisory, right. Lots of folks  
18 won't be able to get that done before they get that  
19 first call, that hold recommendation, right? And we  
20 think there are good policy reasons for grandfathering  
21 hold recommendations, right.

22           One is, there's really a continuation of  
23 advice that was given before the effective date of  
24 these rules, right? To retroactively impose the new  
25 rules, the entire best interest contract standard, on

1 a hold recommendation is fundamentally to  
2 retroactively apply the rule.

3 Two, lots of people have prepaid for ongoing  
4 advice through a commission, right. The typical load  
5 mutual fund structure is an up front commission,  
6 followed by a 25 basis point or one-quarter of one  
7 percent 12b-1 fee out of the fund, right. They prepay  
8 through the commission on an economic basis and then  
9 all the advisor gets going forward is a quarter of one  
10 percent, right. You don't want to take away that  
11 economic benefit of the prepayment.

12 And the second last point is really they're  
13 only paying a quarter of a percent for ongoing advice,  
14 right. That's not the kind of conflict of interest  
15 that you really need to worry about in this rule,  
16 right. It's so small, nobody is going to recommend a  
17 hold on an existing commissionable mutual fund just to  
18 keep receiving a quarter of one percent on what are  
19 really small balance accounts, right.

20 So finally when you think about this, have  
21 other regulators done this? Yeah. The UK when the  
22 banned commissionable compensation really took this  
23 exact approach, right. First of all, they gave  
24 enormously detailed guidance on the transition, pages  
25 and pages of thought on the transition, because rules

1 really, they fall off the tracks on transition. It's  
2 natural to spend all your time focused on the steady  
3 state rule in the future, but you really have to think  
4 about the transition and the UK grandfathered hold  
5 recommendations, allowed the ongoing receipt of trail  
6 commissions, and then they applied the full rules to  
7 sell recommendations, right.

8           So I think our biggest point is we need  
9 clarity on how this transition is going to work. And  
10 we think the rule we're suggesting is really pretty  
11 useful for lots of kinds of investments. You know, we  
12 come at this from the mutual fund perspective. We're  
13 a mutual fund company. But it also works for things  
14 like variable annuity contracts, which are typically  
15 sold with a commission, have ongoing fees out of the  
16 fund, and then typically have surrender charges. So  
17 we think hold recommendations on variable annuity  
18 contracts should similarly fall within this  
19 grandfather rule.

20           And the grandfather we're talking about is  
21 pretty narrow, right. It's not a relationship  
22 grandfather. It's not a grandfather for accounts.  
23 It's really just for the existing assets. It's not  
24 for new money, right. And we think over time this  
25 will kind of fade away organically, right. You'll see

1 the new relationships migrate over time to fee based,  
2 where it makes sense because fee base can be a great  
3 solution for folks, right. And other folks will  
4 choose to maintain two accounts and over time those  
5 accounts will bleed away with ordinary turnover. So,  
6 we think it's a really healthy organic way to approach  
7 transition and we'd really encourage you to take a  
8 look at the UK model.

9 So, thank you.

10 MR. HAUSER: Thank you. I maybe just have  
11 one or two questions for a change. But just your  
12 point about grandfathering these arrangements, you  
13 know, we are looking very hard at how to reconfigure  
14 the grandfather provisions. A number of issues have  
15 been identified in connection with the grandfather  
16 provision, in addition to the one you've identified.  
17 But if in fact, you know, you've already essentially  
18 prepaid, you know, for the advice and for the  
19 investment and it's kind of a front load set of  
20 expenses, you know, I mean maybe on the one hand  
21 that's, that's -- and really we're now just talking  
22 about a small kind of trailing amount -- I mean, on  
23 the one hand maybe you're right, that that's a reason  
24 not to be too worried about the conflict, but on the  
25 other hand it also seems like it would be hard for

1 somebody who is assigned a fiduciary responsibility to  
2 move somebody out of something where the cost were  
3 already essentially sunk costs and now we're just  
4 talking about those 25 basis points, if it's a good  
5 investment.

6 I just wonder if you have any thought about  
7 that. I mean, do you really need it to keep people in  
8 that investment?

9 MR. BORTZ: Yes. So I think what I hear you  
10 say is, hey, if the movement from a commissionable  
11 account to a fee-based program is itself a form of  
12 fiduciary investment advice that's conflicted and  
13 would need to run through a prohibited transaction  
14 exemption, do you need a grandfather; right?

15 MR. HAUSER: Right. If somebody advises  
16 you, you know, pull the money out of this existing  
17 investment that you've already -- and your fees at  
18 this point are -- if you disregard the stuff, it's  
19 already a sunk cost, are pretty small, I mean wouldn't  
20 it be hard for a fiduciary to justify that kind of  
21 advice in the first place? I mean how big is that  
22 risk?

23 MR. BORTZ: Yeah. I think that is fair. I  
24 guess what makes me pause is number one, under current  
25 law, I think the selling of your own advisory services

1 isn't usually viewed as a fiduciary act. In fact  
2 there's a specific example that says selling your own  
3 fiduciary services even when you're already a  
4 fiduciary isn't fiduciary. So I think there's been  
5 that question about, hey, what standard will apply to  
6 sell recommendations. I think the other possibility  
7 is, hey, can I sell my advisory services without  
8 telling you what to do with your existing  
9 investments --

10 MR. HAUSER: I see.

11 MR. BORTZ: -- right. Can I bifurcate those  
12 two things?

13 MR. HAUSER: Right. Because I would  
14 think -- I mean on the first question, I mean it's one  
15 thing to tout yourself. It's another thing to advise  
16 somebody to take their money out of an existing  
17 investment. I mean that strikes me as investment  
18 advice.

19 MR. BORTZ: But you can bifurcate those two  
20 things and in that case you would want to know that  
21 you could give a hold on the existing investment  
22 without pulling in your advisory question, right.  
23 You're bifurcating the two questions, so advisory  
24 services versus the investment recommendation.

25 MR. HAUSER: I don't know. I'm not sure.

1 But on the other hand, maybe it's not worth -- maybe a  
2 broader grandfather provision just avoids me having to  
3 think too hard about that.

4 MR. BORTZ: I like that. You're tired.  
5 It's a long day.

6 (Laughter.)

7 MR. HAUSER: I'm just kidding. Go ahead.

8 MR. PIACENTINI: So I'd like to direct a  
9 question to Mr. Bortz. Just to make sure my  
10 understanding is right, we have a comment submitted  
11 for the record by Drs. Robert Litan and Hal Singer --

12 MR. BORTZ: Yeah.

13 MR. PIACENTINI: -- and that was caused by  
14 the Capital Group that we have that comment, right.  
15 And that comment is an analytic report on what some of  
16 the potential effects of our proposal might be. And  
17 so as I said to Mr. Mason in the previous panel, I  
18 would have very much welcomed an opportunity to talk  
19 about that at the other part of the hearing. So I  
20 won't do a lot of -- I won't address a lot of  
21 technical questions on that to you now, here, but just  
22 to say that, you know, I do have a number of questions  
23 about that report. And I'll just give you a couple of  
24 examples, so that you have a sense of the types of  
25 things that I would want to think through before I

1 understood exactly how to take account of that as we  
2 go forward to a final analytic report of our own.

3           The one that I found the most puzzling I  
4 think is that the report asserts that we have no  
5 empirical evidence for our questioning that disclosure  
6 is unlikely to work, and they say we have only one  
7 experimental study. And I'm pretty sure I know what  
8 study they're referring to. There's an experimental  
9 study that we talk about in there. But we devote  
10 several pages to this topic and we cite a large volume  
11 of published academic literature and authoritative  
12 report from some years back by RAND for the SEC that  
13 found that people don't understand what kind of  
14 advisor they have, what the obligations of those  
15 advisors are. So it's just puzzling to me that that's  
16 missing.

17           A large part of the report tries to sort of  
18 pick apart our analysis, which makes sense, but does  
19 so a little bit on the back of an envelope, turning  
20 our 10-year aggregate numbers into a single basis  
21 point number. They appear to be using simple averages  
22 where a weighted average would have made more sense  
23 because the effects are actually different over those  
24 10 years. So I'm not sure how to read their  
25 translation of what we did.

1           And then maybe just from one other example,  
2 they rely a lot on evidence from Vanguard. Without  
3 making reference to the fact that, as I understand it,  
4 Vanguard's advice program that they're talking about  
5 is a fiduciary advice program, that they tend to  
6 recommend that people invest in very low cost  
7 investments. In fact literature that we're looking at  
8 says other types of advisors often don't recommend  
9 exactly that. So it's hard to see the applicability.

10           And then they look at the results under  
11 target date funds as a proxy for what advisors do and  
12 they attribute a value to getting advice, broker  
13 advice, I guess, to how you would have done in a  
14 target date fund. And then they go on to separately  
15 quantify some value from rebalancing, which it seems  
16 to me would double count something that's already  
17 going on in that target date fund.

18           So -- I mean, those are just some examples,  
19 but there are a number of analytic questions I have  
20 about that report. So I'm really not sure yet how to  
21 take account of its findings in our ongoing work.

22           MR. BORTZ: Sure. So, I mean, thank you,  
23 Joe. And, you know, I'm not going to play arm chair  
24 economist -- I'm so out of my league -- but I'd be  
25 happy to try to connect you guys with Mr. Litan, Mr.

1 Singer, and, you know, hopefully you guys can sit down  
2 and talk it out and understand each other.

3 MR. PIACENTINI: Thank you.

4 MR. HAUSER: And Mr. Murphy, I just had a  
5 question about the asset allocation issue you  
6 identified in associating specific investment options  
7 on the fund menu with those allocations. We had a  
8 number of people suggest, the very first panel on this  
9 program, that one way to -- I think they agreed with  
10 you, that at least when it comes to a plan that has  
11 independent fiduciary oversight, the advantage to the  
12 participants of letting them populate that asset  
13 allocation outweighs, you know, the risk of it not  
14 being associated with the best interest standard in  
15 light of the other fiduciary being in that picture.

16 And what was suggested by a number of people  
17 was, well, if you just populated it with all of the  
18 relevant, you know, designated investment alternatives  
19 that match that asset allocation, that that should be  
20 good enough for us. Or maybe you populate all of  
21 those alternatives and have a provision that, and also  
22 the person making the asset allocation recommendation  
23 and doing the populating doesn't have, you know, a  
24 financial incentive. And I just wondered would that  
25 answer that objection for you?

1 MR. MURPHY: Yes.

2 MR. HAUSER: That would do the trick?

3 MR. MURPHY: That would work.

4 MR. HAUSER: Okay.

5 MR. MURPHY: Yeah. I think the challenge is  
6 that, you know, we have 450 billion in assets on our  
7 platform, but less than 10 percent is proprietary. So  
8 there's thousands of funds that are available. And I  
9 think this was the issue that came up in the last  
10 panel, it's that process of narrowing. And oftentimes  
11 we're asked to play a support role with the advisor in  
12 narrowing that lineup. And, you know, whether it's  
13 using something like a Morning Star nine style box,  
14 what we would want to make sure, particularly as it  
15 relates to these very, very small plans, is that we  
16 can continue to support that process. We don't  
17 frankly have any skin in the game other than trying to  
18 make sure that the right lineup is constructed for the  
19 plan sponsor, for the participants.

20 MR. HAUSER: Right. I mean I think it's --  
21 you know, when we incorporated the education  
22 provisions --

23 MR. MURPHY: Yeah.

24 MR. HAUSER: -- you know, we really were  
25 intending to pick up, and I think we did, all of the

1 original 96-1 education guidance, except that when it  
2 came to these asset allocations, as well as  
3 interactive models, if the advisor or consultant was  
4 tying those particular things to specific funds, that  
5 looked and felt like a recommendation to us. So I  
6 don't know -- but, you know, we weren't carving back  
7 any of the rest of the education provisions and, in  
8 fact, we expanded it a bit with additional retirement  
9 guidance.

10 But we'll go through your comments here and  
11 see whether there's additional clarity you need. I  
12 mean, would it have been the case that under the  
13 original 96-1 guidance too you'd have some anxiety  
14 or --

15 MR. MURPHY: No.

16 MR. HAUSER: -- is it really this asset  
17 allocation issue is the big one?

18 MR. MURPHY: Yeah, I think it is the big  
19 one, yeah.

20 MR. HAUSER: Okay.

21 MR. MURPHY: Yeah.

22 MR. HAUSER: Thank you.

23 MR. CAMPAGNA: Mr. Murphy, on your  
24 suggestions as to the definition of recommendation,  
25 what we did is we looked at the FINRA definition and

1 we used the call for action piece and we put that in  
2 the actual operative text. But if you look at our  
3 preamble, we basically quote the rest of how FINRA  
4 defines a recommendation; that is the closer you get  
5 to something individualized, the more likely it is to  
6 be a recommendation.

7 MR. MURPHY: Agreed.

8 MR. CAMPAGNA: I noticed that you said that  
9 you'd like a different kind of definition, more  
10 slanted towards an actual advocacy of a particular  
11 recommendation.

12 MR. MURPHY: I think it's probably  
13 semantics. I agree that it's individualized, is I  
14 think the right word to describe what we would view as  
15 a recommendation.

16 MR. HAUSER: So maybe you could help us  
17 there. You know, our anxiety generally about  
18 individualized isn't so much that we have an issue --

19 MR. MURPHY: Right.

20 MR. HAUSER: -- with that concept and we  
21 have no problem really with the general parameters of  
22 the FINRA guidance. It's that in this marketplace,  
23 that individualized has been one of the focuses --  
24 foci I guess -- of disclaimers. You know, people -- I  
25 mean there will be all of this education, but there

1 will also be essentially a specific product  
2 recommendation and nevertheless, you know, there'll be  
3 a statement in the materials that says, but it  
4 shouldn't be taken as individualized.

5 MR. MURPHY: Right. But let me just be  
6 clear, we're not in the business of giving advice. We  
7 don't give advice. So what we're referring to is our  
8 ability to communicate with participants and to  
9 support them on questions that they have on the plan.  
10 And our view is that the language is open to  
11 interpretation and it's somewhat ambiguous.

12 Now that might be our interpretation and our  
13 view. I think some of the comments that you made on  
14 the last panel, frankly, gave me a higher degree of  
15 comfort. But that's where we have concerns and  
16 questions. And I'll go back to my testimony when I  
17 talked about the four million calls that we take --

18 MR. HAUSER: Yes.

19 MR. MURPHY: -- and the call types, the  
20 specific things that we're being asked to do.

21 MR. HAUSER: So the FINRA -- you know, if  
22 you just think in terms of the FINRA test, it's  
23 intended to be sort of an objective standard based on,  
24 you know, what a reasonable person would have viewed  
25 as a call to action. But I would think in the context

1 of four million calls, I mean you may well  
2 occasionally have somebody cross the line almost no  
3 matter where we draw that line, won't you? I mean  
4 isn't --

5 MR. MURPHY: I'm not sure. I mean first of  
6 all we monitor all calls. There's no incentive in  
7 terms of the representative's compensation to  
8 recommend or suggest something that wouldn't be in the  
9 best interest of the client. We're not giving  
10 specific mutual fund recommendations. We obviously  
11 don't give specific stock recommendations. So I mean  
12 I suppose, but I'm not sure how to quantify that or  
13 characterize that. I'm not sure how there would be a  
14 violation or what that violation would look like.

15 MR. HAUSER: Okay.

16 MR. MURPHY: Yeah.

17 MR. HAUSER: Okay. I mean so it would  
18 probably be helpful, I mean if you think about the  
19 specifics -- I mean you've outlined a number of your  
20 specific areas here, but if there are other specific  
21 circumstances that you think, you know, may well be  
22 encompassed by this plan level assistance, but you're  
23 not entirely sure about --

24 MR. MURPHY: Yes.

25 MR. HAUSER: -- it, you know, the more

1 detail the better for us --

2 MR. MURPHY: Excellent.

3 MR. HAUSER: -- in writing this.

4 MR. MURPHY: Great, thank you.

5 MR. CAMPAGNA: I'd follow up with that with  
6 the problems you're having with the phrase  
7 "specifically directed." You thought that that was a  
8 concern. Probably comments on that would be welcomed  
9 as well.

10 But there was an earlier example in some of  
11 the earlier panels. If you're in a roomful of people  
12 and you're saying -- you're pointing out specific  
13 people and without considering their individualized  
14 circumstances, you're saying that you should invest in  
15 a particular product. That is specifically directed  
16 and it seems to be along the lines of a recommendation  
17 without being individualized. So do you see a problem  
18 with that kind of scenario --

19 MR. MURPHY: I do.

20 MR. CAMPAGNA: -- that should be addressed  
21 as saying --

22 MR. MURPHY: I do. I do. I mean, I think,  
23 you know, I think anytime -- if I look at it in the  
24 context of the interactions that we have, the first  
25 thing we start with is what's available in the

1 investment line up within the plan, what are the  
2 person's investment objectives, what are they trying  
3 to accomplish, and then we walk them through what the  
4 potential options would be within the context of their  
5 core lineup. So that's very different than the  
6 scenario that you just outlined.

7 MR. CAMPAGNA: Okay. I think there's been a  
8 question kind of thrown and I'll throw it out to all  
9 three of you. A lot of people have been talking about  
10 expansion of the seller's exception to cover all plans  
11 for all participants in IRAs, expansion of the  
12 education exception includes specific advice, and then  
13 tinkering and putting back this mutuality requirement.  
14 And the question that I had and the former panel  
15 member had is what have we gained? Isn't this just a  
16 new five-part test or a new version of the five-part  
17 test? And I just kind of think about your reaction to  
18 that.

19 I mean if you're selling a product, you're  
20 covered in any event. If you're providing specific  
21 recommendation, you can say that it's part of your  
22 education. And as long, you know, there's a concern  
23 over mutuality, which you can disclaim, we're kind of  
24 back where we started. So just the question for all  
25 of you.

1           MR. MURPHY: Well, I mean, I guess the way I  
2 think of it is I think the sellers carve-out, I think  
3 it should extend to all plans. I think that, you  
4 know, whether you're a business owner running a 10,000  
5 employee business or a business owner running a 50  
6 person business, you're a fiduciary under ERISA. And  
7 this is an area that we're really passionate about  
8 frankly because of the challenge we're facing in this  
9 country around the access gap and the fact we have 50  
10 million Americans that work for small companies that  
11 aren't covered by workplace savings.

12           I'm not sure what we're trying to solve  
13 here. I know this year alone just in that space,  
14 we'll sell 3,000 plans through advisors, they all have  
15 an advisor attached to them, and the average size plan  
16 is 50 participants. And some use -- fee leveling is  
17 certainly available. You have advisors that are using  
18 fee-based pricing. But it tends to be a more  
19 commission-based market because plan sponsors found  
20 they don't want to write the check out of their  
21 corporate treasury. So they either charge the  
22 participants, which is disclosed on a monthly basis or  
23 a quarterly basis, or it's paid through 12b-1 fees.

24           But that's all disclosed. Every month we  
25 update on our website broker compensation, the

1 services that the advisor is offering. Because you  
2 can't just look at the cost of the service, you have  
3 to look at it conjunction with the services that are  
4 being provided. We also break down in detail -- and  
5 this goes well beyond 408(b)(2), we break down in  
6 detail the revenue, the revenue that's retained by the  
7 asset manager and the revenue that's retained by the  
8 record keeper.

9 So I guess I just think of a small business  
10 owner as a fiduciary and it's important that the  
11 advisor community remains engaged in that space, if in  
12 fact we're going to solve the access gap. Because as  
13 you would expect, those plans typically are sold,  
14 they're not bought. So that's the way I think about  
15 this.

16 MR. HADLEY: If I could just sort of go back  
17 to your question, which is, you know, all these  
18 recommendations, are they just -- is it just going to  
19 put us back where we are? The first thing I would say  
20 is that the annuity industry that sells in the  
21 retirement market is not looking to put us back in the  
22 situation where people could just disclose out of  
23 conflicts and could disclose out of fiduciary status  
24 through a sentence. We definitely don't want to be in  
25 a position where somebody is acting in a way that a

1 reasonable person would think would be acting in their  
2 best interest and providing investment advice.

3 I think all of the suggestions that you've  
4 been hearing have been about trying to get at, would a  
5 reasonable person think they're getting investment  
6 advice, right? And so making sure that things that  
7 are really education and not advice are covered,  
8 carved out, exception, whatever you want to call it, a  
9 circumstance where somebody really expects they're  
10 being sold a product and does not expect they're  
11 getting impartial advice, all of those at aimed at  
12 trying to get at what I think we all agree, you want a  
13 situation where there's -- if there's a reasonable  
14 expectation that this person is acting in your best  
15 interest, well, they're a fiduciary. Again, I don't  
16 think we're trying to sort of get back to the five-  
17 part test.

18 MR. BORTZ: I mean, I guess, Lou, the only  
19 thing I'd add is in some ways the reg swings from an  
20 extreme where it's easy to disclaim fiduciary status,  
21 to a regime where certain conversations which are  
22 obviously selling conversations are going to get  
23 pooled within the technical definition of fiduciary  
24 advice. And it's how do you kind of find that sweet  
25 spot in the middle.

1           I mean when we sell the American Funds,  
2 we're typically talking to a Registered Investment  
3 Adviser or a broker-dealer firm. There's no question  
4 that we're selling those funds. They're sophisticated  
5 counter parties. They're able to understand what's  
6 going on. That's all we offer, right?

7           But under this reg, I think under a literal  
8 reading, if that broker-dealer, their Registered  
9 Investment Advisor is a fiduciary to a plan, we're  
10 going to get thrown into fiduciary status in what's  
11 clearly a selling conversation. It's just important  
12 to find those situations where this ambiguity that's  
13 sort of driving, you know, a broader definition isn't  
14 present, you know, because there really is low hanging  
15 fruit where people clearly are selling.

16           MR. CAMPAGNA: And if you can indulge me,  
17 going into your comment letter --

18           MR. BORTZ: Yeah.

19           MR. CAMPAGNA: -- Mr. Bortz -- I'm speaking  
20 of the sellers exception, the concept of  
21 wholesaling --

22           MR. BORTZ: Yeah.

23           MR. CAMPAGNA: -- you brought up and it  
24 struck me that that was kind of a new concept that  
25 maybe we haven't explored. And that's the idea that

1 your sales force deals with these financial  
2 intermediaries that aren't really directly connected  
3 to -- they may manage plan assets, but they're not  
4 really directly connected to the plan or the plan  
5 participants.

6 Do you want to describe that a little bit?  
7 And you were asking for basically a tweak to the  
8 sellers exception, so --

9 MR. BORTZ: Yes.

10 MR. CAMPAGNA: So if you could explain that  
11 a little bit.

12 MR. BORTZ: So I think I mentioned this  
13 before, right, we really believe in the value of  
14 financial advice, so we really typically only deal  
15 with retail investors who are working with a financial  
16 advisor. So we direct our selling activity to other  
17 financial advisors, right, to registered broker-dealer  
18 firms, Registered Investment Advisors. And under this  
19 proposal if those folks are fiduciaries, 3(21) non-  
20 discretionary fiduciaries or 3(38) discretionary  
21 fiduciaries, and we make a recommendation, our  
22 wholesalers make a recommendation to that home office  
23 or to that individual advisor, I think under a literal  
24 reading of the reg, that would be fiduciary investment  
25 advice and we would have lot of prohibited transaction

1 issues, right. We're only selling our own products.

2           It seems clear to me that those folks have  
3 the sophistication to know that it's a selling  
4 conversation, that they're not getting unbiased  
5 investment advice and sort of testing for their  
6 sophistication based on like how many assets do they  
7 manage, which you all have a little carve-out in the  
8 proposal. It's just going to be very awkward and  
9 often unworkable, right, is the test whether they  
10 exercise discretion over a certain threshold of  
11 assets. What do we do when they're new advisors? Is  
12 there an aggregation rule? Is it only plan assets  
13 that's under this test?

14           So, we think that's a simplified test where  
15 you look to whether the intermediary is a Registered  
16 Investment Adviser or registered broker-dealer. It  
17 makes a lot more sense and it's a natural selling  
18 exception.

19           MR. HADLEY: If I could just sort of build  
20 on that in the annuity space. One thing we haven't  
21 heard a lot about is terminal funding contracts,  
22 insurance contracts issued to largely terminating DB  
23 plans. This is another circumstance where we've got  
24 this problem that we can't sell the annuity. ERISA  
25 says when you terminate a plan, you've got to buy

1 annuity contracts. You must buy them. Somebody has  
2 got to sell that. And in the context of marketing  
3 that, whether you're talking directly to a plan  
4 sponsor or to a consultant or advisor or somebody  
5 who's acting in the fiduciary capacity, we are not  
6 allowed to make any recommendation that our annuity  
7 may be -- recommend that annuity for that terminal  
8 funding situation.

9 But we think that those conversations could  
10 be very clear that we're talking about -- that it's a  
11 sales context. And if there are conditions that need  
12 to be put in place so that we can sell those to small  
13 plans or sell those to a fiduciary who doesn't  
14 literally manage assets, but is a consultant on DB  
15 plans, we need the carve-out. Again, we're only  
16 talking about a situation where it's clear from the  
17 facts and circumstances that no reasonable person  
18 would think they're getting impartial investment  
19 advice.

20 MR. CAMPAGNA: Would there be some kind of  
21 standard for these financial intermediaries that you  
22 guys could come up with or think about in the comment?

23 MR. HAUSER: Well, I understood you to say  
24 one.

25 MR. BORTZ: Yeah.

1                   MR. HAUSER: Can I -- so, but on the  
2                   terminating annuities, I mean that's kind of an  
3                   interesting context and it raises an issue in my mind  
4                   about maybe what sorts of things should be dealt with  
5                   by exemption and what sorts of things should be dealt  
6                   with by a definition. Because if you think about a  
7                   terminating annuity purchase, I mean that's a purchase  
8                   of -- that may be expenditure of all the assets of a  
9                   defined benefit plan to cover, you know, all of the  
10                  benefits that your employees are going to have for the  
11                  rest of their life -- big, big decision. And if the  
12                  recipient of that recommendation is somebody who  
13                  isn't, you know -- doesn't have some level of  
14                  expertise, you just wonder -- I mean what are we  
15                  losing if we say that's not going to be a fiduciary  
16                  communication?

17                 MR. HADLEY: Well, the person that makes  
18                  that decision is a fiduciary and you have detailed  
19                  criteria they've got to go through. And I don't think  
20                  we should assume in any of this that fiduciaries are  
21                  violating law, in other words not having the  
22                  expertise.

23                 MR. HAUSER: No, no, but, you know, but the  
24                  statute does -- I mean what the contemplates that  
25                  advice to a plan, which operationally means advice to

1 a fiduciary --

2 MR. HADLEY: Yeah.

3 MR. HAUSER: -- for a fee, that's fiduciary.

4 I mean that's just the way the statute is written.  
5 So clearly, you know, a recommendation to a plan  
6 fiduciary is often picked up by the investment advice  
7 definition. And obviously we thought, well, we could  
8 bring some clarity for certain, you know, categories  
9 of recipients, you know, in circumstances where it  
10 seemed highly unlikely that anyone was doing this as  
11 anything other than kind of a counter party  
12 transaction. But I just wonder about -- I mean, gosh,  
13 if somebody is really looking to you to help them  
14 structure the purchase, pick the annuity, should we  
15 just -- I mean it seems like we need to exercise some  
16 care in just giving that a complete pass from the  
17 fiduciary role.

18 MR. HADLEY: Yeah. I'm not suggesting a  
19 complete pass. The sellers carve-out is there for a  
20 situation where a person understands that they're not  
21 getting impartial investment advice and you've got a  
22 bunch of criteria on that. And all we're saying is  
23 that when you're talking about any fiduciary, that if  
24 you have the conditions that you all put in, which to  
25 make sure that they don't think they're getting

1 partial investment advice, that that should apply to  
2 any fiduciary.

3 MR. HAUSER: Okay, understood. All right.

4 Well, thank you all very much for your time.

5 Appreciate it. That's it for today. We'll see you at  
6 nine tomorrow.

7 (Whereupon, at 5:16 p.m., the hearing was  
8 adjourned, to reconvene on Thursday, August 13, 2015,  
9 at 9:00 a.m.)

10 //

11 //

12 //

13 //

14 //

15 //

16 //

17 //

18 //

19 //

20 //

21 //

22 //

23 //

24 //

25 //

REPORTER'S CERTIFICATE

CASE TITLE: Conflict of Interest Proposed Rule  
Meeting  
HEARING DATE: August 12, 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 12, 2015

---

Jen Metcalf  
Official Reporter  
Heritage Reporting Corporation  
Suite 206  
1220 L Street, N.W.  
Washington, D.C. 20005-4018