TESTIMONY OF

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before the

DEPARTMENT OF LABOR

EMPLOYEE BENEFITS SECURITY ADMINISTRATION

HEARINGS ON

29 CFR Part 2510

RIN 1210–AC02

RETIREMENT SECURITY RULE: DEFINITION OF AN

INVESMENT ADVICE FIDUCIARY

DECEMBER 12, 2023

To the Employee Benefits Security Administration
Re: Docket No. EBSA–2023–0014: Hearings, Retirement Security Rule; Definition of an Investment Advice Fiduciary and Associated Prohibited Transaction Exemption Amendments

I hereby submit my Testimony at The Department of Labor's Employee Benefits Security Administration (EBSA) virtual public hearing on December 12, 2023.

Thank you for the opportunity to testify today. I am Kathleen M. McBride, Founder of FiduciaryPath, LLC, a fiduciary best practices training firm, and an ERISA 402(a) Named Fiduciary Expert at Fiduciary Wise LLC, where we become the plan's professional Named Fiduciary and run the plans solely in the highest interest of participants. We do not manage assets or provide investment advice.

I currently serve as Chair of the all-volunteer The Committee for the Fiduciary Standard, an all-volunteer group of professionals who have seen the benefits to clients of advice and investment management in clients' highest interest. These views are my own.

As an Accredited Investment Fiduciary Analyst and with the Centre for Fiduciary Excellence, I've audited the fiduciary best practices of more than 100 organizations, including registered investment advisory firms: recordkeeping and third-party administrators, nonprofits, 401(k) plans, and a tribal nation. We audit their fiduciary investment practices, acknowledge where they conform to investment fiduciary best practices, and where there are opportunities for improvement or if they need to immediately address nonconformities.

The CEFEX assessment process is based on the international standard, ISO 19011: Guideline for quality management system auditing. The assessment is evidence-based, and all work is peer-reviewed by the CEFEX Registration Committee to ensure impartiality and consistency. The standard is discussed in the Global Fiduciary Standard of Excellence as discussed in Fi360's handbooks, "Prudent Practices for Investment Advisors," and "Prudent Practices for Investment Stewards," and ASPPA/CEFEX Recordkeeping services and ASPPA/CEFEX Third-Party Administration Services.

This testimony is based on 45 years of experience in the investment industry with a focus on investment management and fiduciary best practices that help investors reach their goals. It's been fascinating to hear opponents of the Proposed Rule who work so hard on behalf those who want to *appear* to be acting in the best interest of retirement clients but turn around and claim in court to be salespeople just like car dealers.

Financial intermediaries and firms can't have it both ways. Anyone who works with retirement clients, needs to work solely in the highest interest of those clients.

I strongly support the Department of Labor's Retirement Security Proposal.
The ERISA standard of care is what retirement savers expect and what anyone advising them must provide. Anything less than advice or recommendations that are solely in the highest interest of retirement savers is deceptive. When high-expense, cost inefficient investment options are in plans, retirement savers end up with less than they should have in retirement, often missing hundreds of thousands of retirement dollars – dollars that should be in their retirement accounts, not taken from their accounts in the form of high expenses.

The DOL Rule Should Cover Advice to Plan Sponsors
It is crucial for **plan sponsors** to always receive advice that is solely in the highest interest of **plan participants**. That is not covered under the existing law, and as indicated by numerous lawsuits against large plan sponsors, expenses of plan investments and service providers are often much too high. I oppose a seller's exemption carveout. If you look at plan lawsuits, it's clear that even very large plan sponsors are not sophisticated enough to guard against high plan expenses and sup-par fund menus. There is good data now to benchmark plans and that benchmarking is very valuable to plan participants, and a standard service component of the leading fiduciary advice providers to plans.

When plan sponsors receive conflicted recommendations of high-cost plan investment options, those options siphon off money that should be compounding over a lifetime of retirement savings. Sub-par investment menus benefit the seller more than the plan participant. Those excessive costs, risks, and illiquidity jeopardize retirement outcomes. These are permanent harms if allowed to continue, and once those harms are done, they cannot be undone. Advice to plan sponsors needs to be covered.

Costs Matter

Plan investment options that carry high expenses are not cost-efficient. That's a drag on performance. This matters because investments that are not cost-efficient can rob a plan participant of a third, or even half of their retirement savings, leaving them much less secure. Yale's former endowment manager, David Swensen, advised non-professional investors to invest their retirement savings in low-cost index funds. He noted that just 1% in excess fees over the retirement savings years can reduce a retiree's nest egg by half.

While the requirement of fee disclosures in 2012 was measurably helpful bringing down costs for investments and service providers, they are not uniformly clear -- certainly not to the retirement saver. A study by AARP found that 41% of investors "think they don't pay any fees or expenses for their investment accounts." Another 12% are not sure if they pay any fees or investment expenses. Nearly two-thirds, 62%, don't know how much they pay. The study also found that "Two in three investors think that it would be unacceptable for financial advisors to maximize their earnings by selling their clients higher cost investment products when similar lower cost investment products are available." This makes clear that there is deception in some sectors of the retirement investment marketplace.

Rollovers Need to be Covered

Here's a true example.

Richard Smith had just turned 65. After college he joined the Navy, retiring as a Lieutenant. He entered the private sector and saved to create a retirement nest egg. He was a beneficiary of two very large corporate pension plans and a government pension, which provide retirees a monthly check for life.

Shortly after his birthday Smith got a phone call from an "adviser" who began by asking whether he was confident he'd have enough to live on for the rest of his life.

He insinuated that the employers with pensions, one a Fortune 40 company, and the other a Fortune 20 company, might go out of business, taking Smith's monthly pension payments with them. He asked Smith: *What would happen to you then*?

He urged Smith to take lump sum payouts from his two corporate pensions – well into the six-figures – and roll that into a "guaranteed" annuity in an IRA. Each month, it would pay Smith several hundred dollars less than the pension plan, but, he said, "It would be guaranteed." He hounded Smith until he rolled one of his pensions into an IRA, ready for that annuity. This caused irreversible harm. It is too late for Smith, but it's not too late to close this kind of loophole in which a service provider preys on the fears of people who are retiring – even when their pensions are as secure as these were.

It is time to stop this kind of deception and harm to retirement savers.

The proposed Rule's redefinition of fiduciary investment advice is necessary because many areas of retirement advice are not covered under SEC's Regulation Best Interest or NAIC's weak annuities provisions. Retirement savers are left to fend for themselves when products like annuities are recommended. The DOL's proposed Rule would help retirement savers by covering all advice and recommendations on all products and actions pertaining to plans and retirement savers. And Reg BI doesn't cover the problem of conflicts in retirement advice – it only covers securities transactions. The NAIC Model Rule for annuities is weak. Its Best Interest provisions are really suitability, the sales standard, which is not in the fiduciary or highest interest of the participant – it's a wolf in sheep's clothing standard.

The DOL's proposal, which would close some of the most harmful loopholes, such as the five-part test, advice and recommendations on rollovers, annuities, and other non-securities transactions and help retirement savers accumulate more in retirement savings and not be enticed to turn their hard-earned savings into high fee, high commission products that harm the retirement saver while at the same time enriching the seller.

The 1975 Five-part Test.

It is very important for the DOL to close the loopholes in the 1975 Five-part Test. The 1975 five-part test was issued in an era when corporate pensions were the norm, and employers were responsible for providing a pension plan for employees. Now 50 years old and way behind the times, parts of the five-part test have been hijacked, and are used, not to benefit retirement savers, but to pad insurance company's and rep's pockets. It is being used in ways that were not intended, to recommend products that provide higher commissions and fees to the seller. This is a zero-sum game. When big paydays go to the sellers of investment or insurance products, these fees and commissions come out of the pockets of retirement investors. Incentives create even more behavior that runs against the interests of retirement savers. Too often, this takes the form of a hit-and-run sale with no additional advice from the seller. Thus, it's a way for the seller to abscond with more of the retirement saver's money, by selling a one-hit, high-commission annuity that strips the retirement investor of assets and liquidity. Also, when many of these annuities are examined, there is no way that the retirement investor can break-even over the course of their lifetime. But that is not clearly disclosed. And, for indexed annuities, the issuing insurance company can reset the participation rate and/or rate cap annually, and most will do that. That is a distinct advantage to the insurer, not the retirement saver. And, in the likely event that the annuitant dies before full payout, the remainder goes back to the insurance company – unless the annuitant has named a beneficiary and paid for survivor benefits.

In addition to closing this hit-and-run loophole, it would be beneficial for retirement savers if DOL would institute a requirement for every client to be given a written breakpoint analysis, as well as a written, plain language disclosure of all fees, commissions, and other compensation the company, broker, or agent receives. Insurance operatives should no longer be able to bamboozle a retirement saver with, "You don't pay my commissions, the company does."

I would suggest a written breakeven analysis for all annuities, with disclosure of all fees and any other compensation, would be extremely useful to retirement investors. Also, revision of the obsolete 1975 five-part test is crucial, so that even when advice or recommendations are not provided "on a regular basis," or via any of the current five prongs of the five-part test, retirement advice providers (encompassing all who provide advice or recommendations to plans, sponsors pr participants and beneficiaries) have no escape from requirements to act solely in the highest interest of the retirement investor. This would curtail the ability of some industry participants to operate on a hit-and-run basis – as so many do now, perpetuation harmful treatment of retirement investors.

Why it is crucial for all retirement savers to receive advice and recommendations that are solely in their highest interest, from intermediaries who must act as a fiduciary for that advice, without carveouts, loopholes or escape hatches.

Rollovers

A study by Pew Trusts found that rolling out of 401(k) plans costs retirement savers a lot of money once they no longer benefit from institutional share classes a 401(k) would use. “In the aggregate, the amount of retirement savings lost in such rollovers potentially reaches tens of billions of dollars. In 2018 alone, investors rolled $516.7 billion from employer retirement plans into traditional IRAs. An analysis of fee differentials suggests that over a hypothetical retirement period of 25 years, those retail investors could see an aggregate reduction in savings of about $45.5 billion—just from that single year of rollovers.”

Once retirement savers have left the institutional buying power of the corporate retirement plan the news can be even worse if savers are holding mostly equities. The Pew study notes:

“For mutual funds that primarily hold equities, costs are significantly greater for retail shares. Annual expenses for median retail shares were 0.34 percentage points higher than those for institutional shares. Although this seems like a small difference, it represents about 37% higher fees.”

Access, Choice, Compensation

This rule is very different from the 2016 proposal. While it captures relationships and services investors reasonably rely on and view as advisory relationships of trust and confidence, there is no contract/warranty requirement, and no private right of action for IRA investors.

This rule won't result in loss of access because many bona fide financial fiduciary professionals are ready, willing, and able to serve investors of all means based on a fiduciary standard. These advisors already do, with all their clients. Industry claims that the proposal would result in a loss of access to advice are inconsistent with their legal claims before the 5th Circuit that they provide arms' length commercial sales pitches like car dealers, not advice.

This Rule, instead of limiting "access", or "choice" would improve products and services and promote innovation. We saw real product improvements in 2016-2017, but many of the products and services that were announced never came to market after the Rule was struck down. One more thing - this is not about commissions vs fees. Investors would be able to receive advice and be able to pay for it according to a variety of fee models with this Rule.

Those who make those "loss of access" claims would not have been providing trusted advice. Those advisors who DO provide trusted advice in the highest interest of plan participants and retirement investors are fully prepared to pick up any slack should certain firms feel ill-equipped to work in the highest interest of clients of any size, background, or walk of life.

Finally, the framework of PTE 2020-02 and 84-24 and the Impartial Conduct Standards are very important to protect retirement savers from conflicted advice. The Best Interest Standard, reasonable compensation, no misleading statements, practices and procedures to mitigate conflicts of interest, incentives that do not encourage bad advice; the annual retrospective review, and the ability of DOL to request a copy of firm policies and procedures to assess compliance with the PTE – all these commonsense requirements would promote compliance and add protection from conflicted advice.

In short, we hope the Department will pass this Proposed Rule and accompanying revisions in PTEs. A strong final Rule will benefit retirement savers and enable them to avoid many of the most serious and irreversible harms that are present now – and to have a more secure retirement.

Thank you for the opportunity to testify here today.

Respectfully submitted,

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