TRANSCRIPT OF PROCEEDINGS

U.S. DEPARTMENT OF LABOR
EMPLOYEE BENEFITS SECURITY ADMINISTRATION

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

Pages: 350 through 681

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BEFORE THE U.S. DEPARTMENT OF LABOR
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Main Auditorium
Frances Perkins Building
200 Constitution Avenue, N.W.
Washington, D.C.

Tuesday,
August 11, 2015

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

PARTICIPANTS:

Employee Benefits Security Administration:

TIM HAUSER, Moderator
Deputy Assistant Secretary of Program Operations

JUDY MARES
Deputy Assistant Secretary

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Office Director & Chief Economist
Office of Policy and Research

KEITH BERGSTRESSER
Office of Policy and Research

G. CHRISTOPHER COSBY
Office of Policy and Research

LOU CAMPAGNA
Office of Regulations and Interpretations

KAREN LLOYD
Office of Exemption Determinations

PARTICIPANTS: (Cont'd.)

Panel 8 (RIA Panel):

On behalf of Investment Company Institute:

SEAN COLLINS
Senior Director of Industry and Financial Analysis

JONATHAN REUTER
Associate Professor of Finance
Carroll School of Management, Boston College

ANTOINETTE SCHOAR
Professor of Finance
MIT Sloan School of Management

On behalf of American Council of Life Insurers:

CARL WILKERSON
Vice President and Chief Counsel
Securities and Litigation

Panel 9 (RIA Panel):

On behalf of U.S. Chamber of Commerce:

RON BIRD
Senior Regulatory Economist

BENJAMIN F. CUMMINGS
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Senior Fellow
Brookings Institution

J. LEE COVINGTON II
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FRANK O'CONNOR

PARTICIPANTS: (Cont'd.)

Panel 11:

On behalf of Fidelity Investments:

RALPH DERBYSHIRE
Senior Vice President and Deputy General Counsel

On behalf of Retirement Voya Financial, Inc.:

CHARLES NELSON
Chief Executive Officer

Panel 12:

On behalf of Better Markets, Inc.:

STEPHEN W. HALL
Securities Specialist

On behalf of U.S. Chamber of Commerce:

BRADFORD CAMPBELL
Outside Counsel
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JOE COLLINS
Certified Fraud Examiner

On behalf of Garrett Planning Nework, Inc:

SHERYL GARRETT
Founder and President

Panel 13:

On behalf of Janney Montgomery Scott LLC:

GREGORY B. McSHEA
General Counsel

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

JULI McNEELY
NAIFA President
JENNIFER KNOLL, DDS

PARTICIPANTS: (Cont'd.)

On behalf of PIABA:

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

I N D E X

P R O C E E D I N G S

(9:02 a.m.)

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

(Pause.)

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

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

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

With regard to panel questions, the government panel members are interested in developing the public record as fully as possible. We're likely to ask a lot of questions. We're likely to frame them in a variety of ways. You really shouldn't assume based on the way we frame a particular question or even the content of the question that you can guess where we'll end up on the rule. So don't draw any inferences or conclusions on the basis of our merely asking a question.

The hearing is being transcribed, and the hearing transcript will be made available to the public on EBSA's website, hopefully within about two weeks following the close of the hearing. Witnesses will testify in the order in which they appear on the hearing agenda, and we have a few requests for those testifying.

First, if before you testify you could identify yourself and the organization you're representing, if any.

Second, please, and I'm being repetitive, but limit your remarks to 10 minutes. And there is a timer, which I can't see but I trust is over there, which will assist in monitoring time.

Third, please remember to speak into the microphone. That's of particular importance so that our folks can accurately transcribe the hearing, and it also just helps the people in the audience. So, if you could do that, I'd much appreciate that.

This is being streamed live, so we'd love to have you stay all day, but if you want to go watch it on your computer or on your cell phone, feel free, and the site for that is http://www.dol.gov/live.

So I think at the conclusion of this, all public comments and written testimony will be made available on our public website. As we announced yesterday, we've reopened the comment period. You should submit your comments in accordance with the methods that we set out in the June 18 Federal Register notice of the hearing.

We plan to break for lunch at 1:15 today. I know that's late. At 12:15, your natural impulse is going to be to get up and head for lunch. That's okay with me, but you'll miss a really great panel, so you might want to wait 'til 1:15. For your convenience, there's a cafeteria located on the sixth floor of the building which is generally open until 2 p.m., and there's a snack bar on the fourth floor which is usually open until 4.

And hopefully the next announcement will be of no use, but I have to say it.

In the event of an emergency, an alarm will sound. There are two types of alarms. One is a long, loud, continuous tone, which means that we will need to evacuate to get outside the building. An intermittent tone followed by a public address announcement means that we're going to stay here and shelter in place.

If either of these alarms sound, somebody in a yellow hat or vest will pop up and tell you what to do. It's Fred Wong back there. Ah, we have two people.

Please do not plug your laptops, phones, et cetera into the sockets on the wall. Having cords in the walkway is kind of a tripping hazard. And finally, again, make sure your cell phones are turned off or silenced.

And now I'll turn this over to my colleague and fellow deputy assistant secretary, Judy Mares.

MS. MARES: Well, welcome everyone who's just joined us today, and welcome back to those of you who were with us yesterday.

I want to first introduce myself and our panel because you see some familiar faces and you see some new faces. So, as Tim mentioned, I'm Judy Mares.

I'm Deputy Assistant Secretary in EBSA, as is Tim. Next to Tim is Joe Piacentini, EBSA's chief economist. Next to Joe is Keith Bergstresser, followed by Chris Cosby, two members of our Office of Policy and Research.

As a departure from yesterday, today we will focus on the regulatory impact analysis, and you all who are present know the importance of looking at the costs and benefits of regulation, and I will welcome all the panels that are here today.

We can begin.

MR. HAUSER: So we're ready when you are.

MR. COLLINS: Thank you. I'm Sean Collins, Senior Director for Industry and Financial Analysis at the Investment Company Institute, a leading trade association representing mutual funds and other regulated funds in the U.S. and jurisdictions around the world. ICI appreciates the opportunity to testify on this important rulemaking.

The institute agrees with the principle that providers of financial advice should act in their clients' best interest. Consequently, our comments on the Department's proposal focused on the details.

As David Blass, ICI's general counsel, indicated yesterday, we have strong concerns about the proposal, which if implemented, would result in the loss of investment advice for many IRA investors, especially those with low to moderate incomes. We're also deeply concerned about the Department's regulatory impact analysis. The impact analysis must justify the proposed changes. Regrettably, it fails to meet this test and indeed is fundamentally flawed.

The impact analysis argues that the rule proposal might deliver benefits to IRA investors of more than $44 billion a year over the next 10 years or about $4 billion dollars a year. Against that, the impact analysis estimates that the costs of complying with the rule are about $2.4 to $5.7 billion.

The analysis bases this claim and its claim of "a substantial failure of the market for investment advice" on a review of a "wide body of evidence." The central message of this evidence is that brokers provide biased advice, allegedly leading clients to purchase investments that are expensive or to underperform.

We've examined the impact analysis and the academic studies it cites. Unfortunately, they simply do not support the Department's claims of huge benefits. In summary, first, neither the impact analysis nor the studies it cites measure the key factor: is an investor's performance different when an advisor is a fiduciary versus when an advisor is not.

Second, the studies that the analysis cites do not reflect current market conditions.

Third, the impact analysis misapplies the numerical results of a key study, leading to a vast overstatement of potential benefits.

Fourth, the analysis fails to consider readily available data that contradict its claims about broker-sold funds.

Fifth, the impact analysis fails to consider that some investors, particularly those of modest means, may face increased costs if the proposed rule forces them to migrate to fee-based accounts or to go without financial advice altogether.

Correcting for these problems, we find that the impact analysis' claimed benefits of $44 billion over 10 years is totally unfounded. Indeed, even rather basic calculations based on plausible alternative assumptions to those used in the RIA suggest that the rule, if adopted, could cost investors $109 billion in lost returns and added fees over 10 years.

Let me explain. First, the impact analysis and the studies it cites do not, indeed cannot, measure the key question, do investors fare better when using brokers versus using fiduciaries, the same, or worse. No data are available that address that question directly. Consequently, the impact analysis simply cannot use those studies to estimate potential benefits or costs of the proposed rule.

Second, the impact analysis cites academic studies indicating that broker-sold funds underperform. But those studies do not reflect current market conditions. They use data on broker-sold funds stretching back to the early 1990s and in many cases ending generally in 2004.

Since then, however, the market for funds and investment advice has changed fundamentally. In 2000, for example, only half of the funds with front-end load share classes also offered a no-load share class. By 2010, nine in 10 did so, effectively eliminating market segmentation. Funds sold by brokers and funds traditionally described as direct-sold now compete head-on.

Had the impact analysis used more recent, publicly available data, it would have found that investors in front-end load funds bought shares that outperformed, not underperformed. From 2007 to 2013, on a sales-weighted basis, front-end load shares outperformed their Morningstar category averages by 1/4 percent, 25 basis points.

Third, the impact analysis misapplies the results of a study by Christoffersen, Evans, and Musto that forms the linchpin of the benefits analysis. Taking that study at face value, we believe that a correct application of the rule -- correct application of that study to recent data would reduce the claim benefits, stretching the analysis significantly in favor of the RIA, to about $200 million per year at most.

That's far less than the $4.4 billion per year claimed by the impact analysis and is within the range of the impact analysis' own estimates of the cost of implementing the rule.

Fourth, the impact analysis ignored data that contradicted key assertions. Take its claim that brokers do not recommend less expensive funds. In fact, as detailed in our comment letter, investors in front-end load funds, like other investors, gravitate to lower-cost funds. In 2014, for example, for domestic equity funds, the average expense ratio of all funds offered for sale was 1.29 percent. For all such no-load funds, the average expense ratio was 0.97

percent. Investors in domestic equity front-end load funds paid less, .93 percent.

Finally, the impact analysis suffers from two major errors of omission. First, it fails to assess the impact on investors who shift to a fee-based model due to the rule. As ICI and others have detailed, the best interest contract exemption is unworkable. Effectively, investors who want advice will no longer have the option of even considering brokers. Many may migrate toward fee-based accounts. These investors, especially low- to moderate-income investors with lower balances, may end up paying higher overall fees.

Cerulli indicates that accounts with fee-based advisors cost 1.1 percent of assets on a yearly basis, and fees can be considerably higher for balances less than $100,000. Fee-based advisors, like brokers, provide valuable services and deserve to be compensated for those services. But investors with smaller balances may be better served and may pay lower fees under a broker-based model.

The impact analysis also fails to measure the costs of investors becoming disenfranchised from the advice market. The analysis assumes that the rule proposal, if adopted, will drive down brokers' commissions significantly but that brokers will continue to provide the same services to retirement investors as before. That is unrealistic. Some brokers' clients will no doubt migrate to fee-based accounts, but others are likely to be shut out of the advice market entirely.

ICI data indicate that 75 percent of traditional IRA investors have balances of less than $100,000, but many fee-based advisors require minimum balances greater than that. Thus, investors with smaller accounts could end up with no access to advice.

The impact analysis acknowledges that many investors left to their own devices make mistakes, such as saving too little, trading too much, making poor asset allocations, or paying tax penalties on early withdrawals. Advisors, whether fiduciaries or not, can help investors avoid making those kinds of mistakes. If IRA investors with smaller balances, those with $100,000 or less, are unable to obtain advice at a reasonable cost, these mistakes could be quite costly to them.

In our comment letter, using the impact analysis' assumptions about asset levels and the rate at which investors migrate from front-end loads to fee-based accounts, we estimate the mistakes by investors lacking advice could cost $62 billion over 10 years. If the remaining 25 percent of IRAs whose balances are $100,000 or more incur higher fees in a fee-based arrangement, that could cost an additional $47 billion over 10 years, for a total of

$109 billion.

As the Department recognizes, this issue is vitally important to American workers and their families. Research by ICI and others shows that the U.S. retirement system is working to help deliver a secure future for Americans. That could easily be impaired by a rule that's unworkable in its details despite the best intentions.

We hope the Department takes seriously our comments and recommended changes. As a start, the Department should revisit the regulatory impact analysis, which should help it craft a more workable rule. The ICI stands ready to help in this endeavor. Thank you.

MR. HAUSER: Thank you.

MR. REUTER: Good morning. Thank you for providing me with this opportunity to testify.

My name is Jonathan Reuter. I'm an associate professor of finance at the Boston College

Carroll School of Management. I'm also a research associate at the National Bureau of Economic Research and an institute fellow at TIAA-CREF. I am here to testify -- so I'm not here testifying on behalf of these organizations. I'm here to describe my research, which has long focused on the behavior of mutual fund families and their investors.

Today's testimony describes two co-authored papers in which I studied the behavior of brokers in broker-sold mutual funds. These papers have been used by the Council of Economic Advisors and the Department of Labor to argue that conflicted advice is both common and costly. This is an accurate description of my findings.

The first paper studies the portfolios of broker clients inside the Oregon University system's defined contribution retirement plan between 1999 and 2009. We combined administrative data on participant characteristics with portfolio snapshots from three financial services firms, one of which uses brokers to provide investment recommendations in face-to-face meetings. An updated version is coming later this month.

The second paper studies the behavior of direct-sold and broker-sold mutual funds, which Sean made reference to. We analyzed fund-level data on investor flows and returns using data on distribution channels that begin in 1992 and end in 2004. The academic version appeared in the August 2014 issue of the Journal of Finance, arguably the top academic journal in the field of finance. These are independent research projects. My coauthors and I had no financial stakes in the findings.

To summarize, we find that conflicted advice is readily observed in real-world data and in the settings that we study, associated with significantly lower after-fee risk-adjusted returns. I conclude from this research that regulation that reduces the incidence of conflicted advice is likely to increase investor retirement account balances. Reducing the influence of commissions on investment advice may even improve the average quality of broker-sold mutual funds by shifting competition away from broker commissions and toward investor returns.

To be clear, my testimony is not about the inherent value of active management versus passive management, although I'll have something new to say about that, and not a universal critique of brokers and broker-sold mutual funds so much as a critique of broker incentives and client outcomes in the current regulatory regime.

I've structured the remainder of my testimony around three questions which I will answer in the time remaining.

First, what is the evidence that broker clients are receiving conflicted advice? So, we find strong evidence of conflicted advice in two completely different settings. We find that broker clients' portfolios in the Oregon University system are heavily tilted towards those investments that pay the highest annual commissions. This is especially true when comparing options that invest in the same types of stocks or bonds, so, for example, small cap growth funds. This evidence of conflicted advice is inconsistent with brokers recommending the better-than-average funds on their platforms.

Furthermore, because the brokers in our sample sell variable annuities, it is not the case that existing evidence of conflicted advice is limited to mutual funds.

In terms of performance, we find that broker clients earn significantly lower annual returns, lower risk-adjusted returns, and lower Sharpe ratios than counterfactual portfolios based on target-date funds, so the portfolios we think people would have invested in in a world where a TDF is a default. For example, risk-adjusted returns are more than 2 percent lower per year.

The obvious caveat is that we only possess account-level data for a single retirement plan. The lack of academic papers studying the behavior of broker clients and broker-sold mutual funds in the United States reflects the inability of academics to obtain account-level data rather than the lack of interest by academics.

However, it is worth noting that my findings are broadly consistent with account-level studies in Canada and Europe. It is also worth noting that I am willing to analyze a "representative sample of investor portfolios through time" if financial services firms would be so kind as to share these data with me and my co-authors.

When we turn our attention to the universe of broker-sold mutual funds, we find that broker-sold actively managed funds underperform broker-sold index funds by more than 1 percent per year. To be clear, this is not a comparison of broker-sold funds and direct-sold funds. This is a comparison of investment options within the broker-sold segment of the market, which includes funds sold by insurance agents, for example, but does not include funds sold by registered investment advisors.

Despite the significant underperformance, we find that only 2 percent of broker-sold assets are invested in index funds at the end of our sample period. We interpret this underperformance as reflecting the cost of conflicted advice.

Importantly, the underperformance of broker-sold actively managed funds is not an inevitable consequence of active management. In the direct-sold segment, we find that actively managed funds are in the same after-fee risk-adjusted returns as index funds. Rather, it is the consequence of weak incentives in the broker-sold segment.

We conclude that broker-sold, actively-managed funds are of lower average quality than their direct-sold peers because flows into broker-sold funds respond to raw returns and commissions rather than to risk-adjusted returns. In other words, competition in the broker-sold segment focuses on the wrong characteristics, which has implications for how mutual funds are designed.

For example, we show that broker-sold families offer wider ranges of funds than direct-sold families and are significantly more likely to outsource portfolio management, two organizational decisions shown to predict lower fund-level returns. Unless broker-sold families have begun to make fundamentally different decisions about how they design and manage their funds, it is hard to understand how or why the performance of broker-sold funds might have improved. I plan to explore this issue later this year, using distribution channel data acquired from Lipper.

Second, why do we find evidence of conflicted advice in real world data? The simple answer is that investors seeking advice on asset allocation and fund selection tend to have less investment experience than investors who are confident in making their own decisions. This difference in experience significantly reduces the likelihood that broker clients can identify when they are receiving conflicted advice. The fact that broker commissions are typically bundled with other mutual fund fees makes the conflict less obvious.

Participants who joined the Oregon University system before November 2007 had the choice between four investment providers, only one of which offered access to broker recommendations. Using demographic data on participants joining during this period, we find that demand for brokers is decreasing in income, age, and educational attainment. It is also significantly lower for economists and business school faculty. These correlations suggest that broker clients are less financially literate or have less investment experience than other plan participants. Indeed, when we asked participants survey questions about the factors that led them to choose their investment provider, broker clients respond that they valued receiving face-to-face recommendations on asset allocation fund selection.

At the same time, only 23 percent of broker clients agreed or strongly agreed with the statement, I understand how much money my advisor earns on my account. I suspect that the fraction would have been even lower in a more representative sample of investors.

On a related note, I was surprised by T. Rowe Price's claim that salesmanship is a cultural norm understood by individuals as well as plan fiduciaries, no matter their level of financial literacy or investment sophistication. How is a typical investor to know that investment advice offered in an IRA account is held to a lower legal standard than advice offered in an ERISA-covered plan, especially when their initial exposure to financial advice is likely to have come within an ERISA-covered plan? To be honest, I did not fully appreciate this distinction until I began doing this research many years ago.

Third and finally, is conflicted advice better than no advice? So, the answer depends on how broker clients would behave in the absence of broker recommendations, which is likely to vary across settings. Within a defined contribution retirement plan like the one administered in Oregon, however, the answer is no. We find that participants with a high predicted demand for broker recommendations disproportionately choose to invest through brokers when they're available, which is mechanical, and disproportionately choose to invest through targeted funds when brokers are not available.

In other words, when advice is limited to asset allocation and fund selection, we find strong evidence that target-date funds substitute for brokers. This substitution justifies the use of target-date funds as counterfactual portfolios for broker clients, and it ultimately leads us to conclude that conflicted advice is dominated within a DC retirement plan by a sensible default option.

We also show that target-date fund portfolios dominate the portfolios of self-directed investors. Given this analysis, it was surprising to see NERA conclude that Chalmers and Reuter does not provide any evidence that consumers that are currently using brokers would do as well as self-directed consumers if they were left to their own devices. That's precisely what we show.

In analysis that will appear in the next version of the paper, we also find that the portfolios of non-TDF investors joining after the change in menus compare favorably to those of broker clients.

In the context of an IRA rollover, it is unlikely that conflicted advice is better than no advice, especially when the alternative is to leave assets invested in an ERISA-covered plan.

Thank you. I look forward to your questions.

MS. SCHOAR: Good morning. My name is Antoinette Schoar. I'm a professor in finance at MIT Sloan. I'm also a member of the NBER, the National Bureau of Economic Research. And obviously all the comments reflect my opinion and not those institutions.

Thank you for giving me the opportunity to testify before you today. In my testimony, I want to address three distinct questions. First, do conflicts of interest lead to the provision of sub-optimal advice to consumers? Second, how will imposing fiduciary standards affect the provision of services to customers, especially those with small balances? And then third, can market forces and competition alone eliminate conflict of interest given the current regulatory framework?

So, in the following, I will lay out my arguments based on my own research and research I have conducted with co-authors.

So the first question, do conflicts of interest lead to the provision of sub-optimal advice to customers. The current structure of the market for financial advice exposes consumers to a confusing array of different service providers. As we've heard before, they range from registered investment advisers who adhere to fiduciary standards to broker dealers who are only subject to what is known as suitability standards. A large literature has shown that conflicted advice is bad for consumers since it pits the interests of the broker against that of the customer rather than aligning them.

So, when brokers are paid on commission for placing customers into specific investment products, their interest is to maximize these commissions rather than to maximize the performance of the customer's portfolio. These problems are aggravated if customers actually are not aware or if they do not understand the nature of the conflict of interest that their broker faces. But research has also shown that disclosure alone will not fix these problems.

So the fiduciary standard proposed by the Department of Labor seeks to level the playing field and ensure that consumers are not faced with financial service providers whose interests are diametrically opposed to theirs. While surely this rule alone does not solve all the problems that might arise in retail financial services, my research suggests that it will actually help to improve the quality of the advice that people receive.

My research shows that registered investment advisors who have fiduciary responsibility towards their clients provide better advice than those who are just registered as broker dealers. Advisors in my research were less likely than brokers to reinforce erroneous beliefs about the market that clients might have, and they were also less likely than brokers

to -- brokers were less likely than advisors to guide people towards high-fee funds and away from low-cost funds.

So let me explain to you the type of research that we did to support this. So, to test the quality of the advice that is provided by different parties in the market, I conducted an audit study together with two co-authors of mine, Sendhil Mullainathan at Harvard and Markus Noeth at the University of Hamburg, and what we did is we looked at the advice that goes into the investment decision. In particular, we wanted to understand:

First, do brokers and advisors differ in how they correct well-documented biases or investment mistakes that retail customers make. Second, do they differ in how they direct clients towards low-fee investment alternatives such as index funds rather than focusing them on high-fee options? And third, when providing supposedly individualized advice, do these different parties provide specific customized recommendations based on the need of the client?

As you will see, the answers to all three of these questions show that there are big differences between brokers and registered financial advisors.

What we did is we sent mystery shoppers to make more than 250 client visits to registered investment advisers and broker-dealers in the greater Boston and Cambridge area. We then also replicated the study for more than 450 visits in the New York City area. These were professionally trained mystery shoppers who visited brokers and financial advisors to seek advice on how to invest their retirement savings. So these were not MIT undergrads. Don't worry about that.

We also varied the level of bias or misinformation about financial markets and financial products that the clients had to see whether advisors and brokers correct these misconceptions. For example, in half of the visit, mystery shoppers presented mistaken beliefs about financial markets, such as wanting to chase past returns, which has been shown in a lot of research of producing lower returns, and we also used other well-documented biases that have poor returns.

Other mystery shoppers went into the advice situation with what you might call a textbook portfolio, so well-diversified, low-cost index funds.

The results we found were very concerning. Number one, the advice shoppers received from brokers failed to correct their biases. Even more worrisome, most brokers seemed to encourage the existing misconception of clients, especially if it made it easier for them to sell more expensive and higher-fee products to them. For example, they encouraged return chasing but pushed hard against investments in low-cost index funds. In comparison, financial advisors, those with a fiduciary duty, were less likely to engage in this activity.

Second, we found brokers strongly favored high-fee funds, such as actively managed funds, over lower-cost index funds. The only visits where we found that these experts actually pushed for low-fee funds were in financial advice visits -- I mean with financial advisors, not with brokers.

Third, we found no consistent evidence that the advice that was provided took into account the specific characteristics of the clients, such as whether they have children, whether they were homeowners, their wealth level, et cetera.

And finally, we found that actually women were treated as if they were -- the women as clients I mean -- as if they were more gullible than men. In a significant amount of visits, women were asked that they would -- should first transfer their funds to the broker before they could receive any factual advice.

Let me now come to the second point that I want to make. The question is: How will imposing fiduciary standards affect the provision of services to customers, especially those with smaller balances? So this is a concern that has often been voiced by the financial service industry as a response to this proposed Department of Labor regulation, with the idea that it should lead to an increase in the cost to brokers and therefore reduce the services, especially to lower income customers.

But it is actually very important to note that the current system already does not well-serve low-balance customers. We found, for example, in our audit study that individuals who have less than $100,000 in savings found it very difficult to even get a first appointment with any financial advisor or broker. They were routinely turned down.

However, even when looking at customers who are currently receiving advice, this argument is not internally consistent because we need to remember that ultimately it's always the customer who pays for the advice, no matter which form the payment takes. Advisors do not work pro bono, and obviously neither should they. So, if a set of customers has the financial means to pay for the conflicted advice, even though these investments, as we have seen in the statement before, have lower returns, they will know that customers would be able to pay for that advice if it came in the form of non-conflicted payments.

So then the actual argument must be that the industry fears that the only way people are willing to pay for advice is through conflicted payments, where the full costs of the advice are hidden from the customer. In other words, the industry must be implicitly asking whether customers would be willing to pay for this advice if they realized how much they actually are being charged.

But it definitely cannot be in the interest of customers to only be exposed to these conflicted payments. If the fear of providing non-conflicted advice leads to some brokers to drop out of the market, the proposed rule would actually be doing exactly its job by screening out advisors who are not planning to act in the best interests of their clients.

So finally, let me come to my last question. Can market forces and competition alone eliminate these conflicts of interest given the current regulatory framework?

A growing theoretic literature has shown that in markets where a significant fraction of customers cannot differentiate the quality of the products that they're being sold, competition will lead to a race to the bottom. The market for investment advice is one such market. To differentiate good from bad advice, clients cannot go by their experience or even the experience of their friends since it takes decades to know if the advice that is given to them is good or bad.

So actually clients would have to understand financial models and financial theory, which is not something we expect an average customer to have. So many high-quality financial advisors will point out if retail investors are poorly informed, advisors who provide sound financial advice often find it difficult to compete with less sanguine investors.

Therefore, an important additional benefit to a policy that reduces conflict of interest between clients and their advisors is that it helps to harness the market's competitive forces to the benefit of the consumers. Firms now would have to compete on dimensions that create value for their clients rather than just trying to extract rents from them.

As a result, the proposed regulation is quite light touch and pro market since it leaves all the operational decisions to the private sector and allows them to determine how they want to serve their clients. It also does not prevent innovation in the private sector, but it ensures that the incentives of the financial service providers are aligned with their customers. Thank you.

MR. HAUSER: Thank you.

Mr. Wilkerson?

MR. WILKERSON: Good morning. I'm Carl Wilkerson, Vice President and Chief Counsel of the American Council of Life Insurers. Thank you for the opportunity to share the views of the American Council of Life Insurers and our 300 members, who represent over 90 percent of the industry assets and premiums.

ACLI members offer annuities, retirement plans, and life insurance that provide 75 million American families with financial and retirement security. At the outset, I emphasize that life insurers strongly support recommendations and advice in the best interests of retirement savers and clear disclosure of potential conflicts. ACLI is committed to working constructively with the Department to achieve these important goals.

The 25 panels over four days will offer a diverse range of opinions on whether the rule is good, bad, or indifferent. There is one thing, however, that all panelists can agree on. Americans face profound retirement security challenges. The most important consideration therefore is whether the regulation will help solve or will impair long-term retirement security.

We have four core observations about the regulatory impact analysis or RIA. One, the RIA overstates benefits, understates costs, and disregards harm to small retirement plans.

Two, several of the academic studies cited in the RIA are misinterpreted, misapplied, or contain now stale data.

Three, in calculating the proposals made, the RIA fully ignores comprehensive state and federal laws that directly protect the retirement savers against the very abuses that the rule seeks to rectify.

And four, the initiative mentions annuities 172 times, but the RIA contains nothing estimating the impact of the rule on retirement savers using annuities, advisors recommending annuities, or an annuity's role in retirement security.

The statement of benefits is flawed. The RIA cites six academic studies and three working papers to quantify the rule's benefit with data that is sometimes 15 to 20 years old, about one type of mutual fund, at one point in time. Fees and charges have fallen significantly since the data measured in the studies. Moreover, this mutual fund data is not germane to advice about annuities. Even the Department admits that none of these papers tried to detect asset underperformance due to conflicted advice.

The studies serve as a poor measure of the proposal's benefits. Additionally, the RIA does not consider the benefits for retirement savers of annuities, which can ensure financial security for life, or the benefits of in-person advice.

The proposal harms small employers and moderate retirement savers. The RIA fully overlooks the proposal's harm to small businesses and to small to moderate balanced retirement savers. The RIA extols a parallel 2013 initiative in the UK and cites a significant reduction in commissioned advice. It fails to mention, however, an even greater drop in advice overall to retirement savers following that UK regulation.

In 2014, UK Morningstar reported that 11 million investors had fallen through an advice gap following industry regulation. In response to this severe problem, the UK last week launched a comprehensive review of its regulations and its abandoned retirement savers.

It is most telling that the U.S. Small Business Administration, the advocate for small businesses, opposed the initiative for overlooking the impact on small businesses and the loss of advice. Those in the weakest position stand to lose the most from a lack of advice.

Robo-advisors are a poor substitute for human advice. The RIA suggests that robo-advisors will fill any gaps that result from the proposal. Robo-advisors are a new and untested method of providing financial advice and are not necessarily more cost-effective than in-person advice. There are no rigorous studies that have examined whether a robo-advisor is a good substitute for a human being, especially in troubled markets, such as the 2008 market crash.

Moreover, non-commissioned, fee-only advice could likely cost more for many retirement savers because of asset management or wrap fees that are charged year after year after year. In contrast, commissions occur only once, if at all. The RIA failed to consider these factors.

In sum, the regulation is built on two false premises: all commissioned advice is conflicted, and all fee-only advice is always unconflicted and serves the retirement saver's best interest.

Annuities are absent in the RIA calculus. Although the initiative mentions annuities a total of 172 times and acknowledges that 31 percent of IRAs include investments in annuities and that insurance companies will be significantly affected by the proposal, the cost-benefit analysis makes no attempt to examine the impact of the proposed rule on annuities, advisors, insurers, or retirement savers using annuities. That's a blind spot in the RIA.

The extrapolation of front-loaded mutual fund data to annuities is simply wrong and a poor foundation for rulemaking. Surrender charges are misrepresented. Concerning surrender charges associated with insurance products like annuities, DOL's public statements assume that all annuities have surrender charges, full surrender charges are applied 100 percent of the time, and all surrenders are for the full amount of the annuity.

None of these presumptions are correct. Surrender charges are contingent deferred sales charges, meaning that if the customer holds the contract for the surrender period, which is usually seven years, there is no surrender charge. Since the discussion of surrender charges is based on anecdotal information, ACLI commissioned NERA to examine the incidence of surrender charges in a sample of 237,000 variable annuity contracts, representing 30 percent of variable annuity reserves.

NERA's report was published on August 8. It's available on our public website, and it found that 76 percent of those firms surveyed offer contracts with no surrender fees. The average surrender charge for any surrender, full or partial, is .8 percent or .008 in decimal notation.

Of the accounts with surrenders, approximately 23,000 or 70 percent are IRA accounts. For IRA variable annuities only, the average surrender fee paid on any partial or full surrender is even lower, at .6 percent. And lastly, 78.6 of withdrawals in IRA accounts paid zero percent in surrender fees.

This type of data needs to be part of the conversation on the proposed regulation and the RIA. The proposal unacceptably excludes the protection of current regulatory standards from its quantification of need. In its justification for the proposal, the Department asserts that current regulatory protections are inadequate to address its concerns about advice to retirement plan participants. We disagree with the wholesale disregard of detailed systems of significant protection for the analysis of regulatory need.

For example, significantly enhanced FINRA regulations governing variable annuity suitability, supervision, and non-cash compensation were fully outside the scope of the RIA's assessment of need. Likewise, parallel regulations under state insurance laws were fully omitted.

Our submission provides 269 pages highlighting the comprehensive scope of state and federal regulations of annuities. I don't have time to summarize it now, but I think it goes a long way to demonstrate that consumers are adequately protected when you add together state and federal regulation.

The legal standards and exposure to litigation. Congress, courts, and the Executive Branch of government have unequivocally mandated balanced and objective cost-benefit analysis in rulemaking. Collectively, these standards ensure that federal agencies strike the right balance and develop more affordable, less intrusive rules to achieve the same ends, giving careful consideration to benefits and costs. That, by the way, is a direct quote from

President Obama when he issued Executive Order 13563 in 2011.

In its June 29 decision in Michigan v. EPA, the Supreme Court underscored again the critical importance of balanced and objective regulatory impact analysis in federal agency rulemaking. The Department failed these standards by overstating benefits, understating costs, and disregarding harm to small retirement plans. Consequently, the initiative is exposed unnecessarily to legal challenges if the rule is adopted as proposed.

To recap, Life Insurers support the best interests of retirement savers and advice that's provided to them and the full disclosure of potential conflicts. We pledge to work constructively with the Department to achieve these goals and to help solve America's retirement security challenges. Thank you.

MR. HAUSER: Thanks. Joe?

MR. PIACENTINI: Okay. Thank you to the panel for those comments. I'd like to start with some questions for Mr. Collins.

So, Mr. Collins, your testimony and ICI's comment on the RIA spent some attention to the comparison between averages across all funds or funds in a particular category and load funds, presumably mostly broker-sold funds, and find generally that the broker-sold funds performed better than average, had lower fees than average, which is reassuring to know that investors are mostly doing better than, you know, a random choice, if you would, across all funds that might come out the same as the average.

But that leaves open the question of whether the advice could be better, of whether the types of compensation that are paid might affect how much the investments do better than this average.

So my question then is, you know, some of the peer-reviewed research that we relied on did try to look directly at the magnitude of conflicts and concluded that payments that potentially pose larger conflicts seemed to be associated with poorer performance. So my question is, did your examination of data try to isolate the potential size of conflicts and look at whether the performance varied with that or the fees?

MR. COLLINS: That's a -- I think there's probably about four or five different questions in there. But first of all, let me back up. You said that we had sort of -- in the analysis we had done, that we kind of used a random choice of funds. That's not correct. We compared front-end load from --

MR. PIACENTINI: Well, I'm sorry. Let me clarify. I was talking about a comparison to an average, and I was suggesting that if you make a random choice, many times you end up near the average, and that the choices appear to be better than that if they're beating the average.

MR. COLLINS: Okay. So could there be cases where a particular fund underperformed? Certainly. You see that in the data. You also see cases where in the data front-load forms outperformed and outperformed by significantly more than the averages suggest. And so that's the key, is that you need to take consideration of both the guys that are underperforming, the guys that are overperforming, and weight by where investors are making their choices, so where are they buying shares. Where are they holding shares?

And that's a key difference. And the studies that you're referring to generally don't do that. Generally, they look at a specific fund and say how does that specific fund, which may have very few assets or may have very few sales, compare to the average fund.

So just to complete the thought, in the analysis that we did, that's one of the things that we do. We use more updated data, more recent data, which we believe reflects more current market conditions, and asset weight or sales weight as appropriate to the context of the question, and that's how you get the answer that we come up with.

MR. PIACENTINI: But I haven't heard any reference to taking account of the potential magnitude of conflicts and how that might have affected results.

MR. COLLINS: I'm not quite sure how you would do it. I'm not quite sure that any of those studies do --

MR. PIACENTINI: What about the question of whether the magnitude of potential conflicts has any bearing on where the funds are, where flows end up being directed? I heard you say that they are directed disproportionately to less expensive than average funds, but could you see whether the magnitude of the potential conflict to the advisor himself had any bearing on --

MR. COLLINS: Again, if there's a range of potential influences of conflicts, and there could

be -- there could also be, you know, forces working in the opposite direction. For example, brokers think that they will do best in their business if they best represent the interests of their clients.

I mean, certainly our members would say that, that, you know, that's how they run their business, is, you know, do best for your clients, and you'll do best in your business.

But put that aside. What the data show is that people are directing, irrespective of how you were to measure conflicts of interest, the data show that people are directing their assets to front-load funds that either outperformed over the period we considered or had below average expense ratios.

MR. PIACENTINI: That outperformed an average of all funds.

MR. COLLINS: That outperformed an average of funds in that specific Morningstar category. So, for example, if it's a small cap value fund, we compare it, as most of the academic studies you cite, compare it to a small cap value fund.

MR. PIACENTINI: Was there a control for the risk within the category? Does the risk vary within the categories? We heard, for example, some research that took account of Sharpe ratios.

MR. COLLINS: Yeah. I mean, it certainly can vary within the category.

MR. PIACENTINI: So then did your examination take account of whether the Sharpe ratios might be better or worse? You're seeing returns that are compared in one way. Could you see -- was that adjusted on a risk basis the way it was, for example, if I understood in Professor --

MR. COLLINS: No. So that could be done. Having said that, I mean, a number of the studies that are cited in the RIA also -- so, for example, CEM does not, I think, adjust for load on a risk-adjusted basis. So to the extent that that's an issue --

MR. PIACENTINI: Right.

MR. COLLINS: -- it would be an issue broadly.

MR. PIACENTINI: See --

MR. COLLINS: And in any case, I would say that since you're taking averages --

MR. PIACENTINI: Just for -- yes.

MR. COLLINS: -- you're taking some guys that have above average loads, some guys that have below average loads. There will be Sharpe ratios in the same way above average and below average. And I don't think it's safe to assume that because you risk adjust the analysis will come out more in your direction. It could come out the opposite way.

MR. PIACENTINI: Just for the record, so CEM was your reference to Christoffersen, Evans, and

Musto --

MR. COLLINS: Correct.

MR. PIACENTINI: -- one of the papers that we cite. And also, just to clarify, when I said that some of the research we relied on did try to measure the actual magnitude of conflicts and find out whether that seemed to be tied to results, that was a paper that I was referring to.

Let me turn to a couple of other witnesses to follow up a little bit on the same line of inquiry. If I understood correctly, you know, you do see that funds are directed on average toward less-expensive-than-average funds. But going to the question of whether the incentive of the advisor has some bearing on where the funds are directed, I think I heard Ms. Schoar say that in her research it appeared that they did.

MS. SCHOAR: Yes.

MR. PIACENTINI: And in Mr. Reuter's testimony, I certainly heard that it had some bearing on the results. Did it also have some bearing on where flows were directed, the size of the potential conflict?

MR. REUTER: Yes. So the way I had interpreted your question to Sean previously was how does the size of underperformance vary with the level of the conflict, right, or does the extent of underperformance vary with the level of the conflicts.

MR. PIACENTINI: Yeah.

MR. REUTER: And so there are kind of two ways that we've looked at this, right? One is to look at actual broker-client portfolios and kind of ask the question do the high commission funds end up overweighted in the portfolios of the clients. And the answer is strongly yes. The funds that pay 105 basis points a year end up with much higher market share than the funds that pay 55 basis points a year. This is true within asset class.

So the small cap value funds that pay the highest commission get the highest flow in that setting, okay? So that's the first piece of evidence. Those are variable annuities, to be clear, there.

But there is this kind of broader question about underperformance within the broker-sold segment more generally. And the right way to think about asset weighting there at least in the period that we studied where we find that broker-sold index funds vastly outperform broker-sold active funds is to ask what's the market share of broker-sold index funds. And the answer is 2 percent.

So that is a valuated number. It's a striking valuated number honestly. And that's the way we come at the measure of underperformance.

I think if you want to compare broker-sold to direct-sold, that raises lots of questions about selection that are potentially problematic, which is why we look within a particular segment to make these comparisons.

There is one other point I'd like to make, though, which is that the nature of competition in a segment affects the quality of the products you get in that segment. And the way I interpret our findings, using admittedly older data, is that back when we were looking, the broker-sold segment was not competing on risk-adjusted after-fee returns. It was competing on raw returns, which gave them an incentive to ramp up risk. And it was competing on commissions, as we and other people have found in other settings.

And to the extent that you're competing on commissions, you don't have much incentive to create the sort of mutual funds that I would think investors would be better off investing in. And that I think is the fundamental issue here. To the extent that you can change the nature of competition, you can do dramatic -- you can make a dramatic improvement using market forces as opposed to trying to tinker with things around the edges.

MS. SCHOAR: Can I add -- I just want to add one comment to what Jon Reuter just said, because if you -- the research that I described, you know, is actually complementary to his because what we found again, right -- we compare brokers to fiduciary advisors. And we find if you look at the advice going into the situation -- not even the long-run performance, right -- that the quality of the advice that is given to our mystery shoppers varies dramatically whether they meet a broker or whether they meet a fiduciary advisor.

And we find that actually, you know, in some sense, that's really quite concerning, and it goes very much in the same direction, is that only in 7 percent of the visits do brokers -- sorry -- does anyone suggest investment in index funds, right? And we actually find that by a vast margin it's only advisors who even mention these lower-fee options, while, you know, kind of the brokers actually are pushing actively against lower-fee options.

MR. PIACENTINI: So just quickly picking up on both of those last comments, so there was a question raised over whether the RIA had any evidence that compared fiduciary with broker advice, and so I think I'm hearing that this is one piece of research that we can take account of that does that.

MR. COLLINS: Can I respond to that? So I would be very cautious about conflating the issue of active and passive versus broker-sold and fiduciary -- or fee-based sold. So just as an example, let's say you have a broker-sold index fund. It could be a S&P 500 fund. And let's say it sold with a front load. Maybe the front load is waived because it's an IRA, and it's an IRA rollover with a big enough balance. And it goes into a broker-sold fund with, say, an expense ratio of 50 basis points, 25 of that is 12(b)(1) fee.

The correct comparison is to a fee-based advisor who is putting somebody into a low-cost index fund, or it could be an ETF, let's say five basis points, and on top of that adding something like 110 basis points to put together the asset allocation.

So what's going on here -- and this is

very -- you have to be very careful about this -- is that the -- in some sense what's happening is advice is moving from advice within funds, so actively managed funds, advice is bundled with the fund, to advice being provided outside the fund, but investors paying for that directly through an out-of-pocket fee or an account-based fee to the RIA.

And so, again, I would be very cautious about conflating those two issues. They're not the same.

MS. SCHOAR: Can I --

MR. PIACENTINI: Thank you. Just --

MS. SCHOAR: Sorry. Can I comment on this? Because there is actually a different -- a second dimension in our research because, you know, Sean brought up the point of advice. However, we find that as -- if you -- you know, we don't just look at whether people go into active versus passive funds but whether the quality of advice that is given to the clients about how to understand the market is different between brokers and advisors.

And we find, as I was saying before, that the brokers seem to reinforce bad, erroneous beliefs about how markets function if it's in their own interest, which means if it allows them to sell a higher cost -- and also to just sell -- you know, churn the client's portfolio more.

So, you know, forget even, you know, where they allocate them. It is just -- it doesn't seem to jive with our data that, you know, kind of that brokers give the same quality of advice to their customers.

MR. PIACENTINI: Thank you.

MR. COLLINS: Can I jump in?

MR. PIACENTINI: Well, in the interest of time, I do want to get to some other topics as well.

MR. COLLINS: Okay. All right.

MR. PIACENTINI: Okay. Thank you. And I'll try to leave some time at the end.

Just quickly, I heard, Mr. Reuter, you say that the research you were describing, that it pertained at least in part to variable annuities. But I also heard the question raised about whether in the RIA we had taken any account of evidence on insurance products. So that research does tell us something about insurance products?

MR. REUTER: So the Oregon University system, the way it was originally designed, there were four providers. Two were variable annuity providers and two were mutual fund families. And the people we study here, who provided brokers, was one of the variable annuity families. And so, when we were looking at broker recommendations, it was within the context of a menu that's constructed entirely of variable annuities. So, in that sense, yes, we found evidence of conflicted advice in the variable annuity space.

MR. PIACENTINI: Okay. Thank you.

MR. WILKERSON: May I respond to that?

MR. PIACENTINI: Sure.

MR. WILKERSON: While his research, as he explained, did include variable annuities, the point that I was making in our statement is that the RIA itself doesn't take into account the impact on variable annuities advisors to variable annuities or purchasers of variable annuities. Two different things.

MR. PIACENTINI: Okay. Thank you.

MR. WILKERSON: Thank you.

MR. PIACENTINI: So let me ask a different question then to you, Mr. Wilkerson. You point out that, in your view, the RIA does not take adequate account of other protections that are in place. But the empirical evidence that we present and review in the RIA is research that was carried out in the current and historical market under the rules that were in place then. So what additionally should we do to evaluate how people are faring under all of the current protections?

MR. WILKERSON: Well, there's a number of things. I think part of the concern about the absence of a full consideration of the existing laws and regulations, if that's the drift of your question, is that it was in reliance upon FINRA rules that predated the proposal. Things have changed significantly in FINRA, as I mentioned, with regard to incredibly enhanced suitability, supervision, and additional charges for variable annuities. Am I catching the drift of your question correctly?

MR. PIACENTINI: Yes. Is there a specific regulatory reform that you have in mind there that might cause a bend point in the data?

MR. WILKERSON: Let's take non-cash compensations, something that was very much in the forefront with regard to the Department's public statements. FINRA essentially slammed the door on unfair noncash compensation.

MR. PIACENTINI: Okay. I think, though, the research that we rely on mostly deals with forms of cash compensation.

MR. WILKERSON: Well, I think it's part of the total equation, but that is -- you know, if you're going to do a regulatory impact analysis, it should look at the broad horizon of all existing laws and regulations that protect consumers.

MR. PIACENTINI: ACLI's comment in the portion of the comment that deals with the regulatory impact analysis, it makes the point that an asset under management fee might disadvantage annuities as a potential product to be sold relative to a commission model. So that appears to be -- that appears to suggest that the ACLI recognizes that different kinds of payment arrangements can influence which kinds of products will be promoted to customers. Is that an accurate interpretation?

MR. WILKERSON: Yeah. But let me embellish that a little bit. When you're comparing a purchase of a mutual fund or other financial products to the purchase of an annuity, an annuity is a long-term accumulation vehicle that the customer should have purchased with that time horizon of 15, 20, 30 years. It's not something that's appropriate to be churned, as was suggested here. It should be held for the long haul.

There's a single commission paid upfront, and as I mentioned, if people hold it for the surrender period, they never pay the commission. They don't pay the surrender charge. But I think the point to which you're raising is for fee-based advisers who use wrap fees, they don't get a wrap fee.

They can't construct a wrap fee around a variable annuity. There is no asset management needed, no service needed, so they frequently would be disinclined to recommend an annuity to help preserve the financial security of a retirement saver because it's not in their best interests. It's conflicted. They will overlook a product for which they can't get a wrap fee.

MR. PIACENTINI: Okay. Your testimony also raised concerns about small business, that disproportionately is served by the insurance industry in terms of small business-sponsored retirement plans. There is research that was conducted by the Government Accountability Office that we looked at in the RIA that suggested that small businesses are sometimes challenged to obtain fiduciary service in support of their efforts or even to be able to discern whether their service providers are acting in a fiduciary capacity or not. Is that consistent with ACLI's experience, or does ACLI serve -- do ACLI members serve as fiduciaries to small businesses?

MR. WILKERSON: There are -- we're unique in that we have different distribution models. Some life insurers use career agents. Some use independent agents. Some use direct distribution. So there are different levels at each of those. Many of our members have salespeople who are registered investment advisors, registered insurance agents, and also registered reps of a broker-dealer.

So it's a little difficult to give you a precise answer to the question. But there are many in the life insurance industry that do distribute under a fiduciary duty of registered investment advisers but are also subject to very high standards and suitability and supervision under FINRA regs when they're selling variable annuities.

MR. PIACENTINI: Okay. And your testimony also referenced the reforms in the United Kingdom, what they call the retail distribution review, and the potential that that may have caused what some people have called an advice gap, that smaller savers may not be as served as they were before.

You know, the RDR is something we've paid close attention to. You mentioned that there's a new review that's being undertaken, and we're very interested in that. There have been a lot of reviews that have been ongoing of that. We've been following them pretty closely.

So, you know, I think one of the questions for us is how do we draw lessons from that, and there are similarities and there are differences. For example, in the UK, I think that the abuses that they were dealing with were very large and very pervasive, maybe a different kind than we find evidence of here that might have led you to expect that there would be a different kind of market disruption following reform.

We've been told by the regulators there that disclosure as a solution was tried and didn't work. The reforms that they undertook were very different. They banned commissions, and they raised qualification levels. And at least some of the reviews that I've heard suggested that advisers who are closer to retirement were inclined to drop out because of the qualification levels more than a change in compensation.

Advisor numbers did fall but rebounded at least some. It also seems that in the UK there have been other reforms that might affect the demand for advice. There are, you know, new sort of default savings programs in place that give people a different way to prepare for retirement.

To the extent that some small savers are less taking advice now, some of the reviews have suggested that some of that might be the increased fee transparency, and this came up in other testimony, that people maybe didn't realize before what they were paying for advice. So I wonder, do you have a view in light of that, are there particular ways we should draw or not draw lessons for the U.S.?

MR. WILKERSON: Yes. And I concur with your point that it was not a four square identical regulation, but the lessons of less advice to small and moderate savers is unequivocal, and that's troubling for the U.S. markets.

Small advisers -- excuse me. Small savers very much are in need of advice. They're not certain to do inquiry. Let's take the 2008 market crash where the account values could be dropping rapidly. A less sophisticated, small or moderate advisor might be inclined to panic and to lock in their losses by selling in a down market. If it was a long-term accumulation vehicle, like a variable annuity, where they're going to hold it for 15 or 20 years, that would have been a very poor thing to do.

The benefit of an advisor in that circumstance is they would counsel them against locking in their losses and help point them to the fact that they have many cycles to recover and it would be much better not to liquidate their portfolio in a falling market.

MR. PIACENTINI: I've become aware that I've exhausted almost all of our time. I want to turn to other panel members.

MS. MARES: Mr. Wilkerson, I have a question for you. You talked about the protections from the current regulatory standards, in particular, state standards. And I understand that the NAIC in 2010 suggested some model regulation around suitability in annuity transactions. I assume by your nod you're familiar with that.

MR. WILKERSON: I am.

MS. MARES: Can you talk about how many states have in fact adopted the model regulation?

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

First off, that model regulation was drawn almost identically from the FINRA suitability and supervision standard for variable annuities. There are 37 states, if memory serves correctly, that have it. It begs the question what about the remaining states, and that's not to suggest that those states don't have equivalent provisions.

The benchmarks that we had in our materials when we come up with that total tally is states that have the mirror image of the NAIC model. States are independent, and they will vary and add certain different features, but I can say with conviction that the majority of states have essentially the guts of what are in the NAIC suitability and annuity transactions regulation.

MS. MARES: So then I have a followup question because in promoting the model regulation, they said it -- NAIC said it was, and I'll quote, "to better protect consumers from inappropriate and abusive marketing practices." I wondered if you could share with us a vision of what those inappropriate and abusive practices were.

MR. WILKERSON: I can't speculate as to what was in their mind, but generally what that regulation was designed to do, like FINRA suitability standards, to make sure that the advisor who is recommending a purchase or sale of a security, which would include a variable annuity, variable life insurance, takes into consideration the full range of consumer needs.

So that would be their long-term investment objectives, their short-term objectives, their liquid net worth, their other investments and other tax conditions that they may have, so that if there had been some problems with agents who were recommending products that didn't meet those standards, then that regulation should fully address it.

I can give you a little bit of historical background. What that regulation initially began with was a senior protection. It was called the senior protection and annuity transactions regulation. And there were legitimate concerns by the NAIC to make sure that senior citizens were getting a proper match of their needs with the product recommendation.

ACLI fully supports the NAIC suitability in annuity transaction regulation in all the states and the aggressive prosecution of anybody that crosses a line on those regulations.

MS. MARES: Thank you.

MR. HAUSER: So we really are about out of time, but I'm going to ask a question anyway. And this is -- and I'm not an economist. I'm not a finance guy. Feel free to tell me that my question makes no sense. But the obligation is then to tell me why it makes no sense.

So, Mr. Collins, this is really for you. As I understand one of your key modes of analysis, you said if I -- you looked at essentially the simple average of some category of funds, and you compared that to the weighted average of the returns in that set of funds, and you said, well, the weighted average is better than the simple average. Is that about what the number was?

MR. COLLINS: That's one of the comparisons we do, only one, though.

MR. HAUSER: Okay. Well, so let me ask about that. I mean, so if you take -- I mean, how many -- putting -- taking this outside of the broker context, if one were to do that kind of comparison in a context where the people receive no advice whatsoever, do you have any view on whether the unadvised investor is likely to be in the fund that on the asset -- you know, whether the asset-weighted number is going to be better or worse than the simple average?

MR. COLLINS: Well, look, I can tell you what the data say. I don't think I can answer your question because the data to your answer your question simply aren't available, and I'll tell you why. So, if you look across all funds, weighted averages based on assets or sales will tend to be lower than simple averages. So what that tells you is that investors, however they're getting there to those funds, are putting their money into funds that cost less than the funds that are being offered for sale.

Now what you're asking, I think, is can we see, can we say, can we infer from that that RIAs are -- can we infer from that something about RIAs. Well, the answer is yes, but only indirectly. We know the portion that's going into front-load funds because, you know, they're called A shares. We don't know where RIAs are directing investor dollars because, you know, we don't have availability of that account-level data. But I think it's safe to infer that they also are moving investors to lower-cost funds.

MR. HAUSER: But I guess that's the question I'm asking. I mean, I wonder why you say that.

I mean, if on average -- it seems to me the question would be, well, how would the investor have done, you know, with or without the advice and with or without conflicted advice. I mean, one could imagine a variety of scenarios, but it's quite possible in every single scenario, you know, the investor's going to do better on -- you know, that on an asset-weighted basis the average is going to be better than the simple average.

So unless -- so what does that tell us about the nature of the advice or what it did for the investor? I think --

MR. COLLINS: Well, again, the question you were raising in the RIA is how did brokers do for their clients. And the suggestions are that they're putting people into high-fee, low-return funds. And so the easiest way to address that question, to simply ask that question, is let's look and see. Did they put people into high-fee, low-cost funds? And the answer, using data from 2007 to 2013, is no.

MR. HAUSER: Well, I mean, just to -- and I probably am beating a dead horse a little bit, but I don't know that that's quite correct either. I mean, the point of our regulatory impact analysis is that these conflicts of interest are resulting in a reduced performance over what people would receive if they weren't faced with that conflict.

It seems to me, to attack that analysis, you'd have to do something that goes to the conflict being the relevant variable, and you'd have to do a comparison not between a simple and an asset-weighted average but between how the performance is going to vary based on the conflict, wouldn't you? I mean, I'm not an economist.

MR. COLLINS: Well, so if what you're asking is -- the best approach, if it were possible to do, would do a head-to-head comparison between how investors are doing with similar characteristics using

RIAs or fiduciary advisors versus how they're doing with a broker. The data as far as we know don't exist -- Jonathan has got something to that effect.

MR. HAUSER: And I'm not going to stop --

MR. COLLINS: But it's for a single plan, admittedly a single plan in New York -- or single plan in California.

MR. REUTER: Oregon.

MR. COLLINS: Oregon, sorry. A single plan. But, so that would be the best and proper way, I think, to do that. The data is not available, so you in the RIA worked with what's available.

And so I think all we're saying is if you work with what you guys were working with, look at more updated data, and try to evaluate the suggestion that was in the RIA, which is that brokers -- and the language is fairly specific: Brokers are putting people into underperforming funds, higher-cost funds. Look at the data for 2007 to 2014, and that's not true.

MR. HAUSER: I'm just not hearing that your data tells -- that your mode of analysis tells us anything about whether the investor was actually made better or worse by virtue of the advice the broker was giving in particular.

MR. COLLINS: Well, I'd say if that's true of our analysis, it's true of your analysis as well.

MR. HAUSER: Okay. Mr. Reuter?

MR. REUTER: So just a couple quick points. So the first thing is that Sean is right that once you're in the direct-sold space, it's hard to know whether someone made their own decision or whether a registered investment advisor put them there. And that is a completely fair point.

I think the issue that's coming up here is this one of what would people have done if the broker's compensation were different, which I think is the relevant question. What I'm able to do in Oregon is see what happens when a plan changes in such a way that new participants can't use a broker, but old participants could. And there what we find is that what the new participants do is they invest in a target-date fund, which at least over our sample period is lower-fee and higher kind of risk-adjusted return.

So that's an example of taking a broker away and then using -- the people basically self-select into the target-date fund, which was chosen by the plan sponsor, the fiduciary, and at least ex poste have done quite well.

Also, we look at the people who don't go in the target date fund but we think would have wanted a broker. And in some new analysis, which is over a very limited time period, which is basically 2008-2009, so this is, you know, kind of a particular period obviously, we also find that the people who are not getting advice are doing better, right?

So this question of what would people have done otherwise is hugely complicated. The only way we could answer it was to exploit the fact that a plan, because of the Pension Protection Act, basically dropped the provider that offered advice and see what happens afterwards.

I would love to run experiments on people, but that's not something that would be nice for the people being experimented on. And in the absence of that, you know, we can't run randomized controlled experiments the way we can in medicine, right? It's different. And so there are limitations.

I'm happy to get additional data from people in the financial services industry. I promise to just look at it and see what it says because, frankly, I care more about what it says than -- you know, I just want to write a good paper that I can publish someplace. That's all I care about.

(Laughter.)

MR. COLLINS: Could I just follow up on Jon's question for just a second? I know we're running very short on time.

MR. HAUSER: No. Actually, it turns out we have 'til 10:45, so --

MR. COLLINS: Oh, okay. Just to redirect a bit here, I accept everything Jonathan is saying. But again, the question is the relevance for the issue at hand, which is how would people do under a broker model versus how they would do under an RIA or a fee-based model. Their study addresses the question of how would you do with advice versus no advice. Different question.

MR. HAUSER: So may I ask -- and I may be trying to get at the exact question. Are you aware

of -- well, anybody on the panel. Can you point me to any literature that's either peer-reviewed or not funded by the industry groups or a financial services company that shows better investment outcomes, you know, associated with conflicted advice models?

MR. COLLINS: I don't know of any, but I would stand that statement on its head and say just

as -- by the same token, I don't know of any studies that show that brokers are putting people into -- you know, providing worse outcomes. You know, as I said at the outset, our understanding is that brokers, just like fee-based advisors, try to do best by their clients because they think that that's how they'll get the most business.

MR. HAUSER: And why is the -- I'm sorry, Mr. Wilkerson. You wanted to add something?

MR. WILKERSON: I just wanted to answer your question. I too am not aware of any studies, but I too would flip that on its head and say it begs the question are there any studies evaluating whether or not an advisor who charges fees only, no commissions, but assesses a wrap fee year after year after year, and what kind of drain on performance that inflicts on consumers that have made that choice for advice.

MR. PIACENTINI: So a lot of this most recent discussion has focused on, you know, should we be comparing fiduciary, fee-based advice to commissioned advice. Is that really -- and there's been some assertions that that really is what we should be doing. And yet I think, you know, what the proposal attempts to do is make it possible to preserve a commission model but with stronger protections to mitigate conflicts so that they don't have the potential to bias advice.

And so I would submit that a lot of what we tried to do in the regulatory impact analysis was focus on the question of conflicts. And is there evidence that conflicts are influencing advice, and if so, to what effect that has on investors? And we looked a variety of evidence, including mystery shopper studies, including actual account-based results, including comparisons of funds similar to what's offered in the ICI letter but that was done, you know, by some other authors in different contexts, with somewhat different findings on somewhat older data.

So I guess my question is, you know, why is it that a comparison of fee-based and commissioned is the point when what we're I think trying to do in the proposal is find a way to make sure that a commissioned-based model can thrive but without a risk that it will introduce harmful bias. And so that's what we were trying to study. It's a question of bias in --

MR. COLLINS: Is that a question for me or --

MR. PIACENTINI: For anybody on the panel.

MR. COLLINS: Well, so again, I think the first thing is -- and I'm sure you're probably very tired of hearing, you know, people say this, what I'm going to say.

MR. PIACENTINI: Right.

MR. COLLINS: But, I mean, we support a best-interest principle. So I don't -- again, that's not the issue. The issue is the devil is in the details. How do you get there? And I think there's a lot of concern not just by us but across the industry in general that in the particular details of this particular proposal there's a risk that a number of investors, especially those with small balances, small to moderate incomes, will be shut out of the advice market.

So you're trying to control conflicts. Understand that, get that. But the way in which you do that is critical. And if you get the details wrong and you shut people out of the advice market, the examples that we show and we showed in our comment letter show that that could be very costly for society in general. And so I think that's part of our message in our comment letter, is that I think if you get the details right in the regulatory impact analysis, it will help you better understand how to craft a rule that avoids issues like that.

MS. MARES: Mr. Collins, I'd like to follow up with that. You said in your oral testimony that the proposed rule forces a move to fee-based accounts. So, first of all, I'd like to take some exception to that because I don't think our rule forces that. And you also just said that you support acting in the customer's best interest.

If staying in a commission-based account, as we've heard testimony many times yesterday, is in the customer's best interest, why would you force people to move to fee-based accounts?

MR. COLLINS: So again, I think some people, some -- you know, the view is that under the rule as currently structured, some people will undoubtedly migrate from broker-sold funds to fee-based accounts. Some of the people that migrate will undoubtedly pay higher fees than they would pay.

One example of that -- and I think you have this in the comment letter -- is what do you do about people that should have been grandfathered, for example, preexisting accounts. Are they knocked out of their preexisting account where they've already paid an A share commission upfront? And let's say they paid that three years ago. Now they're forced into a fee-based account and they've lost that front-load commission. So that's an example of how they could end up paying higher fees.

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

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

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

So, as an example of that, yesterday one of the panelists said, look, the average account balance in my firm is: for average account balances below $25,000, we put everybody into a broker-based arrangement. The average account balance in his firm I think was $50,000. So in his firm -- and he's a fee-based advisor -- 20 -- everybody with $25,000 or less is still going into a broker-based account.

So what happens to those people after the rule? I don't know. I don't think -- he seemed to think that he would be willing to continue to serve those people. I don't know. But I will tell you that our data, ICI's data, about 50 percent of the IRAs have balances of $25,000 or less. So, to the extent that there are fee-based advisors who are unwilling to deal with small accounts like that, they're being dealt with now because they worked pretty well in the broker-based model. Those accounts may simply lose advice.

MS. SCHOAR: Can I -- sorry. Can I just quickly comment on this? I think it's exactly right that, you know, very small accounts -- for very small accounts, the relative cost of providing advice is high, right? And as we said before, so Sean is right, that as we said before, no matter how you structure the advice, right, given that brokers' or advisors' time is valuable relative, right, to the size of the account, it's an expensive proposition.

I don't think anyone, you know, kind of disagrees with that. I think what, you know, at least I personally would suggest people to really think about is that the advisors' or the brokers' time has to be paid for under either of these models. And in a way, you know, kind of the difference is how this payment is structured. And I feel the more the client actually understands what they're paying for, the more they can evaluate whether the quality of the advice and the service they're getting is in their interest.

And I would even -- I would also agree with Sean that maybe a fee structure that is, you know, kind of a yearly or, you know, quarterly wrap might not be so good for people who have a very small account.

But we know -- I mean, you know, I have full confidence in the innovativeness of industry, right? I mean, and we have seen models where actually advisors are paid, say, for the hours that they're spending, not for in a continuous way, right? And so that could actually allow even small account holders to get some advice and indeed pay for the advice that they're getting because, again, like we don't expect an industry to work pro bono. That makes no sense either.

MR. PIACENTINI: So just quickly I want to apologize for any confusion I caused earlier. I was so accustomed to the one-hour panels before. But the good news is that means that my fellow panelists also will get a chance to ask you some questions.

MR. COSBY: Good morning. Thanks for your testimony. We really appreciate it. I had a question for Mr. Reuter. You had talked about some difficulties you had encountered getting data. You cited -- you said that in your Oregon paper that's the only time that you were able to access account-level data to do your analysis. I was just wondering if you could talk a little bit about what your efforts have been to try to obtain this data and what you've encountered in that quest.

MR. REUTER: So getting account-level data on broker clients is tough, and if you ask firms, they'll typically say no. The reason we were able to get the data in this particular case is that this relationship was a relationship within a retirement plan in a state in which I happened to be employed at the time. And so we were able to go to talk to people who were basically running the plan and say, look, we know that you're evaluating how the plan is working for participants, that this is motivated partly by the Pension Protection Act, and we'd like to get some data and see what these data say.

And so, in their capacity as the plan sponsor, they were able to get us the data and they were able to facilitate the matching. So we got the data for all the financial services providers. They went to Oregon. There was someone there who basically took the Social Security numbers, came up with a way to anonymize them, match them, give us the data.

I don't know how that long that process took them, but it was a process that we very much appreciated. And in the interest of full disclosure, the data we got from the provider that worked with the brokers was actually the most comprehensive data we got from anyone. It was not, however, the case that they would let us know who the brokers were. So the one thing they wouldn't tell us was which broker works with which clients. But in terms of, you know, how contributions were working and snapshots, they were kind of the most comprehensive.

I am in the process of doing some work with TIAA-CREF. That's, I suppose, public -- it's on my

CV -- although it's not really looking at these sorts of questions. They were trying to understand how menu design affects demand for advice within their system. But that's only something I was able to do based on a relationship I formed with them over many years. It's hard. I mean, it's hard to build trust, and it's hard to get legal to sign off on giving academics data honestly.

MR. COSBY: Thank you.

Ms. Schoar, I wanted to ask you a question about your mystery shopping experiments that you performed. What kind of implications does that have for clients that are looking for advice when there's a market downturn? Do you think that there could be negative implications based on the incentives that the brokers are getting in terms of the advice that they're providing in those circumstances?

MS. SCHOAR: So we conducted our first study actually in 2008, and then the follow-on study was done three years later. So the results that I, you know, reported to you were, you know, actually in a market downturn situation or at least going into a downturn. This was the beginning of 2008.

You know, just to be very clear, our mystery study, mystery shopper study shows kind of at the point of a client for the first time accessing either broker-advisor the type of advice that they're getting.

What we unfortunately cannot see -- and that, you know, goes back to the difficulty of obtaining data -- is now how would this relationship develop over time, right? And would the client, say, with an advisor versus a broker, perform differently in a downturn, right, or an upturn.

The one thing I can say -- and, you know, of course, this is extrapolation from our mystery shopper study, though, as I was saying before, right -- by the way, you know, everybody on the panel has already alluded to the fact how difficult it is to know the counter faction of what would have happened had we randomly assigned somebody. At least in this study we actually did randomly assign customer with different mistakes about the market to different brokers and advisors.

So at least at the moment of first visit we have a sense of, you know, how brokers and advisors deal with different type of customers.

And so the one thing that we see or what we found is that customers who have what people call return-chasing biases -- which means, you know, kind of that you look at the past performance of an industry or even a stock and, you know, you buy into a stock that performs very well, which is a very well documented bias that retail customers have, and which has been shown in study after study to have very bad, you know, return for customers -- that is something that actually especially the brokers actively supported.

And, you know, in a way, it's because in the commission model it makes it easier to kind of sell different stocks to people, especially when performance of a stock or an industry changes.

MR. COSBY: Thank you.

And my final question is directed to Mr. Wilkerson and Mr. Collins. Mr. Reuter brought up in his testimony the important question of whether conflicted advice is better than no advice. And implicit in your testimony seems to be that access to advice for small savers could be cut off. It seems like their research is indicating that some of these small savers are detrimentally affected by conflicts. So my question to you is, is conflicted advice better than no advice in your opinion?

MR. WILKERSON: I think no advice is very detrimental to small and moderate savers. They need advice. And so maybe I wouldn't use the word conflicted, but people that have variable compensation or commissions, left to their own decisions -- for example, in the 2008 market crash, people could have made very poor decisions that were detrimental to their long-term retirement security.

MR. COLLINS: I think what I would say is that it sounds like the question is should we force people in low-income, moderate-income brackets, low-balance funds, into a no-advice situation. And I think our view would be better to let them have the choice because they're the ones that know their circumstances best. So the rule as currently structured we think precludes that, and it would be better to let them have a choice.

MR. HAUSER: I wonder, though, if there isn't something a little -- I mean, I wonder if that really is a choice issue in a way.

I mean, if you go back to a comment Professor Schoar made, I mean, folks are paying for this advice. They're paying for it in the form of the money that's coming out of the investment that they're making. That's not terrifically visible to them.

And presumably, if that's enough money to get a broker to render this service, one could just as easily, you know, enter into an arrangement with a customer to say, "here is how much I'm going to charge, it's going to be upfront, and I'll put you in whatever is best for you." That's completely unconflicted. It's completely transparent. You would have no need of a prohibited transaction rule or special conditions or anything.

But I gather that the concern is that a customer confronted with that might choose -- I mean, I guess I'm wondering if it isn't fear of choice, that the customer would choose not to take that advice if they were told, look, there really isn't a no-fee option. I mean, one way or another you're going to pay a fee. Are you willing to pay this fee for advice? I mean, first off, what do you think of that characterization? And second, how should I think about that problem?

MR. COLLINS: First off, I don't think that characterization is correct. If you're in an A share, a broker puts you into an A share, you know upfront what you're paying. They tell you. They show you the fee schedule. The fee schedule of the front-load fee has to be disclosed in the prospectus. So that's just an improper characterization.

Now there is -- you know, with an A share, normally you'd have a 25 basis point 12(b)(1) fee. But you could also have the same kind of a fee on a no-load fund. You could have one on a retirement -- I think it's probably an R1 share or maybe -- oh, I'm sorry, R6 or R5 share, where there's a 25 basis-point 12(b)(1) fee.

So I think that's not a correct comparison. Again, I think the issue that you're asking about is are people better off with advice or not. Should people pay for advice or not? And personally I think the best answer to that question is it's best to leave that decision to the individual in conjunction perhaps with an advisor because they're the people that know best their circumstances in their entirety. And if you force people into certain situations, that may not be the best outcome for them.

Personally, if somebody told me I couldn't use a broker and I wanted to use a broker, that

would -- you know, that would constrain my choices, and I wouldn't necessarily appreciate that.

MR. HAUSER: Yes, Mr. Wilkerson.

MR. WILKERSON: Let me just answer your question. I'll follow on Sean's comment. We support full disclosure of all fees and charges. We worked with the SEC and FINRA to come up with a very clear point of sale document that was user-friendly, plain English, streamlined disclosure so people could make those choices and comparisons.

I also wanted to differentiate your question. You said is there one of the problems that there isn't a choice for no commission. And it differentiates, say, the purchase of a load mutual fund. So you buy 100 shares, and on your confirmation statement, it says you bought 100 shares, and here is what the commission was that you paid.

If you contrast that with an annuity sale, no commission comes out of the customer's pocket immediately. The life company fronts the commission to the sales agent at the outset. There is a surrender charge that if the customer leaves his long-term accumulation vehicle before the seven-year period, they will be assessed a downgraded surrender fee to recoup what the life company invested in funding the commission to the sales agent.

But if the customer bought it for the right reason, holds it for the long haul, they never pay a commission. So the option that you pose, is there a fear of no commission, that's a very viable option in the sale of insurance products.

MR. HAUSER: So I think we've come to an

end. I mean, I would just like to reiterate, you know, a point that was made in the discussion between you and Mr. Piacentini, which is that our goal is in fact to preserve both of these models, I mean, not to force people, you know, in or out of a particular model.

And, of course, there isn't a mandate anywhere in the rule that people choose one option or the other, that, in fact, what we're trying to structure here is an arrangement that permits a commission-based model but does it in a way that tamps down the effect of conflicts of interest.

What I'm hoping is as we continue these discussions we'll figure out the best way to achieve that goal.

MR. COLLINS: I think that's what we're hoping as well, and we stand ready to help. And I think that, you know, again, our suggestion is go back and revisit the RIA, and hopefully that will help you in that process.

MR. HAUSER: All right. Thank you very much.

ALL: Thank you.

MR. HAUSER: The next panel.

(Pause.)

MR. HAUSER: Okay. We'll get started again in just a moment.

(Pause.)

MR. HAUSER: Okay. Mr. Bird, whenever you're settled.

(Pause.)

MR. BIRD: Good morning. I'm Ron Bird. I am the senior regulatory economist at the U.S. Chamber of Commerce.

I'm glad to be back here in the Labor Department, amongst familiar faces, old friends. I used to work here in the Office of the Assistant Secretary for Policy, and where I had the pleasure to review and draft many a regulatory proposal from all of the agencies. And I used to be also for many years a federal contract economist who did regulatory impact analysis support work for a number of the agencies in this Department and the Energy Department and EPA and so forth.

I'm here on behalf of the U.S. Chamber of Commerce and our members. And my approach here is not to address the pros and cons of some of the issues, for example, that the previous panel addressed very competently. I'm here to look at the regulatory analysis process and the regulatory decision-making process as a process.

My question is not did you come to the right answer or the wrong answer. Did you come to the answer that you've gotten by the right process? And could your answer therefore have been made more credible, more reliable, and certain if you had addressed the process in certain other ways?

And I've developed these kind of structures from my own perspective, but this involves input from member companies at the Chamber, all of whom are committed to the basic principle that regulatory decisions on any subject should be based on sound, scientific, and statistical and economic evidence. And here I'm addressing the adequacy of the regulatory economic analysis that's presented as the basis for the specific proposal that is here and the proposed PTEs in your notice of proposed rulemaking.

Now, Executive Order 12866 and Executive Order for President Obama's more recent executive order, 1213563, form a basis, a referential basis, for a lot of what I will say here.

But I'm not just speaking to the specifics of the executive orders. These executive orders reflect also a sort of codification of what I think is good common sense, what has evolved over many years among economists, among public policy analysts, as an appropriate way to approach the important duties of making regulatory decisions.

In particular, EO 12866, which provides the framework that all executive agencies are supposed to follow, was I think conceived in the 1970s and the 1980s in part as a bulwark against the charge of arbitrary and capricious rulemaking. And this framework provided by Executive Order 12866 and further strengthened by President Obama's 13563 executive order, was designed to ensure that rulemaking decisions were made on the basis of demonstrated evidence, and that the reasoning underlying a decision was well-documented, and in fact could be replicated by an objective observer.

Rather than add -- and I've been around the rulemaking business for a long time, and I know that there are time pressures and there are budget pressures and all of these things. And I have heard -- I have heard some of you, and years ago, complain about the burden of having to go through all of this detail required by the executive orders.

MR. HAUSER: None of us, surely.

MR. BIRD: Oh, it wasn't you, Tim. I swear it wasn't you. And it wasn't Joe. And so maybe it wasn't anybody up here. But it was somebody. I've heard this in this building. Okay. I will absolve you two of any of that. Thank you. I think you understand this.

But what I want to say is that in fact rather than adding a burden to regulators, to your job, I think the requirements really are liberating for you because they should be seen as a means of protecting the agency from charges of arbitrary and capricious action, and also of protecting yourselves. Most of you, you know, are career civil servants. You're dedicated to serving the public interest.

I remember the first time I walked into this building and took a government job. I had to raise my right hand and swear to uphold the Constitution of the United States. And that's a solemn oath, and actually, especially for the career civil servants as well as those who are here only for a time. The executive orders protect your professional integrity, to do the job the right way, which I know is what everybody really wants to do.

And I think if an agency diligently follows the requirements and the intent of the executive orders by making regulatory decisions based on rigorous regulatory impact analysis, the risk of cost of litigation, the risk of attendant delay, and actually getting the job done that needs to be done for the public interest, those risks are reduced if you do the job right.

Now, our examination of the regulatory impact analysis has found a number of significant -- I think significant flaws, and I think flaws that you can correct. And frankly, I hope that before you proceed to a final rulemaking, even if -- you know, whether you're proposing a -- in the final, you go with this proposed approach or some other, or whatever. I hope that you will prepare an amended regulatory impact analysis that addresses some of these flaws. Particularly the flaw that I'm going to mention in a minute about failure to fully examine the cost and benefits of alternatives, and present -- Before you public a final rule, I would hope that you would publish for public comment the revised regulatory impact analysis. Which should be a document offering alternatives that is the basis for the administrator to make a final decision. And put that out for public comment so that it can be further refined and improved upon.

Some of the failures -- I think that you've failed to present an adequately detailed baseline description of need for the regulation and of the entities and transactions and outcomes associated with the rulemaking baseline.

I think you really need to go do more field research to describe really what is going on. How many people fit in what box? What boxes give what results? Really describe the context of the field you're operating on because that's important, and then framing properly your questions about the need for the regulation.

Another failure is to adequately compare fully benefits and costs of multiple alternatives. And you list some alternatives, sort of as an afterthought at the end of your RIA. The alternatives ought to come up front, and every alternative ought to be fully subjected to cost/benefit analysis. You've done an interesting and fulsome job of looking at some of the elements and so forth of the cost and benefits of your favorite proposal, but what are the costs and benefits of the others?

And you've got my comment letter that lists all of these, but I'll just -- I think an important failure is the failure to adequately address the risks of a big change in the environment, in the marketplace that this regulation intends to make. And I think that especially President Obama's executive order gives you a good basis for taking a little different approach there.

I mean, you go assess a problem -- and I'm -- this is my last minute -- and you see: here is how things are, and here is how things ideally ought to be over here. And, you know, if we just did A, B, and C, we could just move the world in one fell swoop from its existing flawed and troublesome circumstance to perfection, okay, or at least something a whole lot better.

The problem is when you're dealing with something really big like the financial markets -- and first, the financial markets -- you really have to be careful about unintended consequences. And, you know, you are the agent of Leviathan. That's what Hobbes 400 years ago called the government. And there is a reason -- that's an appropriate term.

A Leviathan is a huge beast, you know. And it can be a force for great good, but its very hugeness brings forth a risk, a risk of while Leviathan can see the danger over the hill, if Leviathan is not careful in running over the hill, Leviathan is going to trample over five or six villages on the way. And you don't want to do that.

That's why small steps, incremental steps, in many regulatory contexts -- and I don't know what those steps might be in this one, but in general, small steps, incremental steps are very useful because those marginal, incremental steps actually mimic what the market itself does as it responds to things that it can respond to.

And it gives you a protection against those unintended consequences because if you don't -- if you take small steps and then do what President Obama has said you should do, build into your regulatory process a procedure to evaluate after the fact, retrospective analysis, to evaluate what you've done, and then say, okay, is this having an effect. Do we need to go further? Do we need to back off? Do we need to adjust?

You can achieve getting from here to the ideal over a period of time it may take years. It could take a decade or even two. But, hey, this country has been around for over 200 years, and we plan to be around for a lot longer, toward a more perfect government, a more perfect society. We move incrementally.

So if you adopted more incremental approaches rather than a fell swoop, that would be --

would be perhaps a prudent approach that would -- okay. I'll conclude here because my time is up, and there are a lot of other things I would be happy to talk about. I wish we had more time. And I hope somebody is going to ask me the question that is there -- have I ever met a regulation impact analysis that I liked.

MR. HAUSER: Well, was it this one?

(Laughter.)

MR. BIRD: Well, okay. So that --

(Simultaneous comments.)

MR. HAUSER: I mean, at the risk of -- and let me just -- let me just say, we will -- this is a -- this panel has a little more time than most. So I hope I didn't lose my credibility with any speakers to come. We really do want people to stick to the ten minutes. But I was a little intimidated that I'd be seen as an overbearing Leviathan if I tried to stop you.

(Laughter.)

MR. BIRD: You're the agent of Leviathan.

(Simultaneous comments.)

MR. BIRD: The metaphor of Leviathan is not a pejorative thing. In fact, Hobbes was promoting the idea of the government as an overweening power to restrain things. But the important -- the thing you get out of -- go back and reread the book, Leviathan. The important thing is that that power has to be used with discretion. And sometimes that power is more effective when it's held as a contingency than when it's actually exercised.

MS. MARES: Okay. At this point, I'm going to exercise my power. Mr. Cummings.

MR. HAUSER: Thank you. A much more effective agent.

(Laughter.)

MR. CUMMINGS: Already we're off to a more unique tone than I had anticipated. Well, I want to thank the panel for allowing me to speak today. I also want to thank you personally for the time and the effort that you have exerted and will continue to exert in crafting this rule, which is clearly intended to protect American consumers as they prepare for retirement.

My name is Benjamin Cummings. I'm an assistant professor of financial planning at St. Joseph's University in Philadelphia, where I also serve as the academic liaison for our CFP board-registered financial planning program. I've also obtained my certified financial planner certification.

So although I will echo the thoughts of others who have spoken and written about this issue, the thoughts I express are my own. In a large part, I agree with the proposed rule, although I do see some areas for improvement.

I come today out of concern for consumers of individualized advice regarding retirement assets. I also come out of concern especially for seniors, who are especially vulnerable to expensive and complex financial products that can be difficult to reverse.

Lastly, I'm also concerned for the taxpayers who forego tax revenues in an effort to encourage individuals to save for retirement through tax-sheltered retirement accounts like 401K plans and IRAs. The intent of these accounts and their favorable tax treatment is to enhance the retirement savings and preparedness of Americans. However, excessive rent extraction can create a significant drain on accumulated assets.

At the same time, the financial products available to consumers within these retirement accounts can be complex, and many individuals benefit from the assistance of a financial professional.

Yet it's well established that the advice they receive may not be in their best interest, and evidence is widely cited that investors are confused about the duties of care to which financial professionals are held. As these points have been widely discussed, I would like to focus my comments on areas that in my opinion may benefit from additional attention.

First, I want to briefly reiterate what others have said and written regarding what I argue is an unfounded claim that the rule will limit access to financial advice for middle-income households. In their comment letter for this proposed rule, the Financial Planning Coalition cites considerable evidence to the contrary.

To highlight just one of their examples: in a study of advisors who are personally familiar with operating under a suitability standard and a fiduciary standard, 80 percent report either an increase or at minimum no change in the range of services when operating under a fiduciary standard. This suggests that providers who are willing to operate under a fiduciary standard could -- oh, sorry.

To suggest that providers who are willing to operate under a fiduciary standard could not easily fill any potential gap left by advisors who are unwilling to rise to the occasion seems rather naive.

Second, I would like to emphasize the importance of incentivizing financial services firms to better align policies, training, and supervisory practices with the interests of their clients. Much emphasis has been given on the need to align the incentives of advisors with the interests of their clients, but less attention has been given to the culture of the firms which employ advisors.

Currently, many firms recognize the conflict of interest that exists for their advisors, yet they do little more than disclose those conflicts. For example, in their comment letter related to this rule, the Financial Planning Coalition cites part of a form ADV of a large financial services firm. The form states the firm's advisors have a conflict of interest based on an incentive to recommend investment products based on the compensation received rather than the interests of the client.

The Financial Planning Coalition also references the code of conduct of a large insurance firm, which, quote, "states that rather than acting in the client's best interest, advisors must act in the best interests of the firm," end quote. The proposed rule is certainly an attempt to align the incentives, not only of advisors and their clients, but also of firms and the clients of their advisors.

To aid firms in the desired direction, I draw from legislation passed by the Washington state legislature in which they define the standard of care for medical professionals as, quote, "that degree of skill, care, and learning possessed at that time by other persons in the same profession," end quote. I emphasize the learning aspect, which is imperative when providing expert advice on complex subjects like medicine.

Similarly, I believe that one way financial firms can be incentivized to better align their interests with those of their clients is to provide guidance about the training and educational attainment required of their advisors, especially when they provide advice regarding complex financial products. Too often advisors provide advice about and promote the sale of products that they do not fully understand themselves.

If advisors do not fully understand the products they sell, financially unsophisticated clients certainly cannot be expected to make fully informed decisions about such financial products. Most importantly, I question how such an uninformed advisor can act in the best interests of their client.

Third, I am concerned about the continued allowance for financial services firms to require mandatory pre-dispute arbitration clauses. In an article in 2010, Arthur Laby, who testified before this panel yesterday, commented, quote, "Unlike court litigation, arbitration generally does not yield a well-reasoned written decision," end quote.

According to recent data from FINRA, breach of fiduciary duty is consistently the leading controversy involved in arbitration cases, yet little is divulged about the legitimacy of the claims or the resolutions of the cases.

This lack of transparency makes it difficult to identify whether investors achieve some sort of financial restitution as a result of these claims of a breach of fiduciary duty. Allowing firms to require arbitration cases involving breach of fiduciary duty as it relates to registered representatives of a broker-dealer has led to what Laby argues is, quote, "an underdeveloped jurisprudence," end quote.

Another concern about mandatory arbitration is that depending on the regulatory regime of the advisor, investors in retirement plans may have access to only one of two rather dissimilar routes to seeking redress for allegations against an advisor, yet few consumers realize the distinction.

This spring, the Consumer Financial Protection Bureau did a study on the impact of arbitration cases, and found that, quote, "More than 75 percent of consumers surveyed did not know whether they were subject to an arbitration clause in their agreements with their financial service providers, and fewer than 7 percent of those covered by arbitration clauses realized that the clauses restricted their ability to sue in court," end quote.

The CFPB study also finds, quote, "no evidence of arbitration clauses leading to lower prices for consumers," end quote. With little evidence of its benefit to investors, I question the value of continuing to allow financial services firms to use mandatory pre-dispute arbitration clauses.

To conclude, the main concerns I hope to address today are, number one, claims that the proposed rule will limit access for middle income households to receive individualized advice are unfounded. To the contrary, considerable evidence suggests that services either remain the same or increase under a fiduciary standard.

Number two, only educated and well-informed advisors are capable of providing quality advice in the best interests of their clients. Firms need regulatory incentives to properly train and educate their advisors.

Number three, allowing firms to continue the use of mandatory pre-dispute arbitration clauses limits the benefits of the proposed rule.

Thank you for my comments, and thank you for your time.

MR. HAUSER: Thank you.

MR. WEBB: Okay. My name is Anthony Webb. I'm a senior research economist at the Center for Retirement Research at Boston College, and the comments are my views rather than those of the Center or Boston College.

So thank you for inviting me. It's my pleasure to be here. Since the Employee Retirement Income Security Act was passed in 1974, the retirement savings landscape has been transformed. Nowadays, most private sector workers, if they have a retirement plan, are covered by a 401K, where the participant is responsible for investment allocation and draw-down decisions. Importantly, most DC assets are actually not even in 401K plans. They are in IRAs when investors are not currently accorded ERISA protection.

We face a retirement saving crisis.

Research by the Center for Retirement Research shows that more than half of working-age households will not be able to maintain their standard of living in retirement. Now, many factors have contributed to the crisis, but high fees and subpar investment returns have played a significant role.

Even seemingly small differences in investment returns accumulate to large amounts over time. Some simple math shows that the 1 percentage point annual reduction in investment returns will decrease retirement assets by about one-fifth of retirement.

A recent report by the Council of Economic Advisors estimated that conflicted advice decreased investment returns by about 1 percentage point. And there is about 1.7 trillion of assets that were subject to conflicted advice, which gave a loss of about 17 billion a year. To put this number in context, it's between one-quarter and one-third of the tax expenditure on 401Ks and IRAs.

I believe that the Council of Economic Advisors' number is in the right ballpark, but possibly a little low for three reasons.

So number one, it excludes 401K plans. And many plans are great, but some have high fees and poor investment options.

Number two, about 600 billion of the 1.7 trillion is invested in variable annuities, where fees can often be much higher than the one percentage point.

And number three, it excluded advised assets other than load mutual funds and annuities. And research has shown that investors in brokerage accounts also suffer from conflicted advice.

On the other hand, although as the fees have been trending down over the last ten years -- and on balance I think that the one point -- the 17 billion is probably a lower bound estimate. So we have a big problem that needs to be addressed. And we obviously want to address it in the cheapest and least intrusive way.

Now, one approach might be to mandate greater disclosure. I have nothing against greater disclosure, but I don't see it working on its own. There have been many academic studies that show low levels of household financial literacy, and it's simply asking too much to expect households to read disclosures, understand them, sort of figure out what action to take, and then implement a decision.

So since disclosure won't work, we need

regulation. Now, let me say a few words about the structure of the proposed regulation. Now, number one, it replaces the existing five-part test for determining fiduciary status by a new four-part test. The regulations apply this test not only to 401Ks, but also to IRAs and IRA rollovers.

Number two, it creates six carveouts. So if you fall in one of the carveouts, you're not deemed to be a fiduciary. And then finally, the regulation creates exemptions, the most important of which is the best interest contract exemption. The BIC exemption allows fiduciaries to receive commissions subject to conditions designed to safeguard investors.

Now, I strongly support the new four-part test. The old five-part test was a broken reed, and advisors could easily escape fiduciary status by claiming that there was no mutual understanding that the advice should form the primary basis of the investor's decision.

I also strongly support the decision to apply the proposed regulation to both IRAs and rollovers and to IRAs. The bulk of money these days in IRAs is 401K rollovers. So these accounts are really an integral part of the retirement system. On job change, the household's option is often to leave its money in a 401K rather than to roll it over into an IRA. But the problem is advisors have an incentive to recommend a rollover.

Under the regulation, advisors would only be able to recommend a rollover when the rollover is in the household's best interest, not when it is merely suitable.

Now, while carveouts mostly cover situations in which fiduciary status would not be appropriate, I have the concerns about the carveout for platform providers. Research has shown that mutual fund families acting as trustees for 401K plans favor their own affiliated funds, especially their poorly-performing funds, to the detriment of plan participants. So I would favor eliminating the carveout.

As an alternative, the U.S. could either follow UK practice and prohibit platform providers from getting fees, or alternatively create an exemption similar to that applied to broker-dealers. And yet another alternative would be to restrict the carveout to platforms servicing large plans. And the carveout should definitely not be extended to platforms servicing IRAs, where the protections are weaker.

I'll now move on to the part of the regulation that has led to the loudest protests from the financial services industry, the BIC exemption.

Now, can I start by stating in contrast to what has happened in other countries, this is very much light-touch regulation. The argument could have been made that we should have followed the example of others and eliminated sales commissions altogether. But officials at the DOL had made a judgment call that they could secure their objective through less intrusive regulation, and I support that decision.

Now, some parts of the industry argue that the BIC exemption is unworkable and will lead to advisors abandoning large sections of the population and pushing others into more expensive fee-based advice. Now, if you're willing to make really extreme assumptions about the number of people who might lose access to advice and the value of that advice, it is easy to show that the cost of the regulation exceeds the benefits. All you need is an Excel spreadsheet.

But these assumptions are simply not credible. We're being asked to believe that returns of the BIC exemption are so burdensome and so onerous that the industry will choose to walk away from 1.7 trillion of assets, and perhaps 17 billion of revenue, rather than make an attempt to comply with them.

Now, what the industry characterizes as insuperable obstacles are to my mind just minor in course. I'll give you one example. The exemption asks the advisor to disclose the fees on an investment over a holding period. And the industry argues that making such an estimate is impossible because the cost depends on the return and holding period, both of which are unknown, and different companies might be making different assumptions, and any assumptions might conflict with the FINRA guidelines.

Now, all of these concerns are valid, but none of these problems are insuperable. One might as an example have a stipulation that companies should use reasonable assumptions. In this, as in other areas, the BIC exemption would benefit from tweaking, but I think that the overall structure is correct.

So to summarize, I view the proposed regulation as a carefully crafted attempt to address a serious problem. I think that the DOL has struck a nice balance between doing enough to be reasonably certain of improving conduct, and not doing so much that it limits a consumer's choice as to how they receive advice. And I thank you for your time.

MR. HAUSER: Thank you.

MR. PIACENTINI: Okay. Thank you to the panel. And I think I will ask questions in reverse order at this time. So to start with Mr. Webb, one of the points made in your written statement, it warns that when households don't understand fees, fees will be inefficiently high. Can you elaborate on that a little bit? What does inefficiently mean in this context, and why is that the case?

MR. WEBB: Yeah. So if households were aware of the level of fees --

MR. PIACENTINI: Into the microphone.

MR. WEBB: Sorry, yes.

MR. PIACENTINI: Thank you.

MR. WEBB: If households were aware of the level of fees, they would carefully trade off the level of fees versus the level of service and possibly the level of investment performance. Now, if households are unaware of the level of fees, then investment companies have an incentive to increase the level of fees and use the extra fees on advertising to generate new business.

The equilibrium will be where the marginal revenue from the extra fee is zero.

MR. PIACENTINI: And do you believe that that is the case in the market for investment advice, investment products, today?

MR. WEBB: My suspicion is that we have a segmented market, that we have -- we have some people who are aware of the level of fees and go for low-cost funds, and we have other people who aren't aware of fees and go for the highly advertised, heavily marketed, high-cost funds. And only that can explain the coexistence of high-cost and low-cost funds in the market. I don't think it's a function of differences in distribution costs.

MR. PIACENTINI: Okay. Let me shift topics a little bit. One more question for you, Mr. Webb. So your testimony says that arguably maybe we should have considered even a more aggressive reform, something closer to what was done in the UK, although you agree with the decision that was made to propose something that you've characterized as a lighter touch.

So we've heard some testimony that what has happened in the RDR in the UK maybe resembles Mr. Bird's Leviathan, and that it has had some unintended consequences. But in your view, a more aggressive reform like that in the UK, and in the UK experience so far, has that been on balance positive or negative for consumers?

MR. WEBB: Right. So despite the accent, I'm not that familiar with what has been going on in the UK.

MR. PIACENTINI: You did mention that in your testimony.

MR. WEBB: The UK has faced different and more serious problems.

MR. PIACENTINI: Sure.

MR. WEBB: My understanding is that it has not led to a mass exodus of advisors. Obviously, it is very early days, and we have to see how things play out. But I have looked at data on the number of advisors. I have looked at the profits of direct sales investment companies. And they seem to have coped relatively well with the reform.

MR. PIACENTINI: Okay. Thank you. A couple of questions for Mr. Cummings. So if I understood your testimony correctly, it's your view that under the type of reforms that we have proposed, that impartial and independent advice could be available to middle class investors, that it need be too expensive. Do I understand that?

MR. CUMMINGS: Yeah, by all means. I don't think there is anything in the proposal that should suggest that it's going to limit access to advice. I think there is ample evidence of firms that already provide advice under a fiduciary model to these households, and if advisors or unwilling or don't want to step up to that challenge, there are plenty of others that already do provide advice and a fiduciary model that will fill that gap.

MR. PIACENTINI: So part of the conversation that we've heard about this topic suggests that some of these market entrants that can provide inexpensive advice are limited to just algorithm-driven robo-advice, and that there is not human contact, and that that might not be adequate or sufficient or even something that some consumers would want to take advantage of.

Do you think that affordable advice will be so limited, or can those technologies support models that are broader than just pure robo advice? What is your view on that?

MR. CUMMINGS: Well, I think a few things. As it relates to robo-advice, one is that as a teacher of financial planning education, I have a great concern about the future employability of my students. And I have looked to the firms that I believe we're referencing, that they are one of the highest -- one of the largest employers of undergraduate graduates of financial planning education.

And so I look to those firms as the future -- the future of our industry in a large sense because they now have designed a model for entry-level positions in financial planning. So really, it seems to me that some of these firms have provided a great innovation in the industry to allow us to shift our onboarding process of new advisors.

I mean, we're well aware in the industry that there is a demographic concern of predominantly older advisors providing advice, and that new advisors aren't coming onboard under old business models. And so introducing new business models is actually helping re-energize the industry for younger advisors.

So I think on one side, a lot of these advisors actually are providing new job opportunities for students who want to work in financial planning and provide advice. Also, these students are more akin to providing advice digitally or virtually, and so they are okay with having virtual meetings and web conferences.

So even though they may not be sitting one-on-one with an advisor, a lot of these robo-advisors aren't just algorithms, but they are actually supporting that with personalized advice, either on the phone or some sort of a web conference.

As an aside from the robo-advisors, there are other models out there that are also providing advice through financial planning networks. I think one that easily comes to mind is the XY planning network that is designed specifically to target clients from generation X and generation Y. And these advisors that are part of this network agree to and sign a fiduciary oath, and provide -- they are also included, or include within their practice, some sort of compensation model that is amenable to low and middle income households.

So the business model certainly exists, and I think that they can certainly scale to meet any sort of changing demand, and that they are ready and willing to provide fiduciary-level advice.

MR. PIACENTINI: Okay. And we've heard in your testimony and in preceding panels that consumers sometimes can't tell whether the advice that they're receiving is potentially conflicted or not, and so forth. You talked about the culture of conflicts or customer interest in some of the firms.

So my question is, given that there is this new entry and innovation going on in the market that you've described, is there under the current rules a risk that it could be -- it could become conflicted because of the way that competition has evolved in the past? Is the new model potentially vulnerable to that?

MR. CUMMINGS: You know, some comments in response, and I'm not sure if this is getting directly at your question, so feel free --

MR. PIACENTINI: Sure.

MR. CUMMINGS: -- to clarify if this doesn't address it. One of the concerns that I've had as we've discussed and gone through this process, or heard a lot of these testimonies, is quite honestly any compensation model involves conflicts. And so our objective isn't to remove conflict. It's to minimize conflicts and recognize them when they do exist.

I think although I tend to favor a registered investment advisory business model, I think that often they lay claim to the high ethic road of operating under a business model that has no conflicts. And I disagree with that approach, that whenever you're hiring an agent to act on your behalf, that there is inherent in that relationship the possibility for conflicts.

So I think what we're intending on this -- and I think this is also stresses the importance of the fiduciary standard because what we're saying is regardless of compensation model -- because we can recognize that all compensation models are going to have at least some element of a conflict of interest -- that we need to, because of that inherent conflict of interest in hiring an agent, we need to have a fiduciary model.

I don't know if that completely addressed your question, so feel free to clarify.

MR. PIACENTINI: That's close enough.

MR. WEBB: Okay.

MR. PIACENTINI: The last question for you. Your testimony addresses the issue of complexity in products and how that can create challenges for advice and for consumer decision-making. So I guess my question is, if there are potential conflicts in the market, does complexity interact with the degree of risk that might be posed by conflicts, and are there particular products or modes of distribution of products that might raise or lower concerns about the challenges of complexity?

MR. CUMMINGS: You know, I think part of the concern that I have regarding the complexity is that often complex products are marketed towards financially unsophisticated consumers. And so rather than these products being purchased or being sought out by a consumer, they're often being pressured and sold by an advisor, so that the impetus of the potential transaction comes from the advisor rather than the consumer.

So the consumer is seeking some sort of advice, doesn't know the landscape, and is instead presented with a potentially complex product that they may not fully understand, but because of some element of trust with the advisor, is going to rely or accept the idea that this product is in the best interests of the client.

MR. PIACENTINI: And what is causing the advisor to do that?

MR. CUMMINGS: I think largely it's their compensation. But even outside of that it's -- yeah, I guess I would say largely compensation is what is driving that. But I think inherent in that could also be some element of the culture that you were talking about as well, that there is -- the concern that I have regarding the culture is as I have sensed in some firms, and not all firms, that there is an element of a desire to provide advice without necessarily seeking out proper education about the products that they're pursuing.

MR. PIACENTINI: Okay.

MR. CUMMINGS: So part of it could be that because of the compensation model, that then becomes the advisor's driving force without any sort of proper education about the products themselves. And so absent more information on the advisor's side, they're going to pursue what is in their best interest on a compensation basis since they lack or arguably lack the information about the products to make a more informed decision themselves.

MR. PIACENTINI: Thank you.

A question for Mr. Bird. So I very much appreciate the experience that you bring to the table with, you know, a long experience with regulations and with doing economic impact assessments of regulations. One of the challenges I think that we face, and maybe particularly with respect to financial regulations, is thinking about all of the potential indirect effects. And I think, yeah, that there has been a lot discussed already today about potential unintended negative indirect effects.

But I wonder if sometimes there are also unforeseen positive indirect effects of regulations.

One of the things that we have trouble predicting is how technology, market entry, and those sorts of things will proceed under a reformed regulatory environment. And I'm thinking -- you mentioned you have experience in environmental regulation, how -- and, you know, you probably know more about this than I do.

But, you know, there has been at least some record of environmental regulations where the costs have ended up being lower than had been anticipated by the industry, sometimes I think even than had been anticipated by some of the regulators, that, you know, cap and trade allowances for emissions have ended up falling in price faster than some might have expected because the market was able to adjust in ways that hadn't been foreseen.

So I guess my question is, you know, should we be taking account of that in thinking about how advice might be accessible or priced under a regulatory regime that might impose some different constraints around things like incentives.

MR. BIRD: I think what you're asking me is, first of all, are there both beneficial as well as costly indirect effects --

MR. PIACENTINI: Yes.

MR. BIRD: -- and especially you're referring to the technology-driving aspect of some aspirational regulations, particularly out of EPA. And then you're -- but you're also asking how -- whether and perhaps how you should take into account those.

There -- while it's very true, certainly, that there are unintended consequences in both ways, and you're doing the right thing in thinking about what those might be, I would encourage you in a better revision of your RIA to actually lay those out, what the negative ones and the positive ones might be, and think about it in a systematic way to -- and I know you can't put firm probabilities on it, and this will happen, that will happen.

MR. PIACENTINI: Right.

MR. BIRD: But if this happens, how would it affect results? If this happens, how would it affect results? Can we postulate relative likelihoods? Can we draw from other examples like you did from the EPA example there? Mentioning that, and if I were reading your RIA critically, as I did, I would mark that, if you had that in there, as a plus.

MR. PIACENTINI: Maybe under a heading of uncertainty, to use a term that --

MR. BIRD: Yeah, absolutely. And I think --

MR. PIACENTINI: -- in the executive order, for example, that you referenced.

MR. BIRD: -- one of the real lacks, lacking areas, in your -- the present draft RIA is that you haven't addressed the risks and uncertainties, I think, thoroughly enough.

MR. PIACENTINI: So you found a chapter that we dedicated to uncertainty to be not sufficiently --

MR. BIRD: It could be better.

MR. PIACENTINI: Okay.

MR. BIRD: It could be better.

MR. PIACENTINI: Thank you.

MR. BIRD: It could be better, and I'll be happy to -- and I think I have addressed that somewhat in my comments that you have in writing. But we could -- I could further expand on those if you'd like.

MR. PIACENTINI: But it is appropriate that in there we tried to consider both negative and positive --

MR. BIRD: Oh, yeah.

MR. PIACENTINI: -- potential and foreseeable --

MR. BIRD: Absolutely, absolutely, absolutely.

MR. PIACENTINI: Thank you.

MR. BIRD: And just to take that one step further, though, the -- you can't just rely on good things happening, no more than you can predict with certainty that the bad things will happen.

And one way to improve that risk analysis is to back it up with some -- with more research. With more research where you could, for example, go out and conduct an experiment or conduct a survey that begins to provide you with information about what sort of responses actually are likely to certain stimuli. And also, by looking at other -- other rulemakings and other research in other contexts and what that light can spread on that.

So those are some ways that could be improved and elaborated, I think, more.

MR. PIACENTINI: Thank you.

Okay. Other panel members?

MR. BERGSTRESSER: Yes. A question for Professor Cummings. You mentioned that you would like to see us or perhaps a regulator incentivize firms to provide training to advisors. And I was just wondering if you could elaborate on specifically how -- I know you probably don't know all of the levers we have, but some -- a little bit more specific on how you would do that.

MR. CUMMINGS: You know, largely that was I guess just a plug for the current proposal. I think that by designing regulation that will encourage advisors to act in the best interests of their client, it naturally incentives firms to provide the training that is necessary so that advisors can fulfill that duty.

So it was more a roundabout way or a different perspective of a similar article -- or argument. Just to suggest that it's not just the relationship between advisors and the clients that we need to consider, but also the firms. And so this proposal really does help align not just advisors with clients, or the interests of advisors with clients.

But it also helps align firms. Because they naturally have an incentive to, rather than word in their code of conduct that their advisors have an incentive to the best interests of the firm, they now have to change their code of conduct and their culture so that their advisors have the incentives to act in the best interests of their clients.

So I think in large part this proposal does accomplish that. And then I would leave it largely up to the innovation of the firms to determine how best to implement that. And I just hope that they do take this as an opportunity to better educate and train their advisors.

MR. BERGSTRESSER: Thank you.

And a question for Mr. Bird. You mentioned doing more research, and one of those possibilities to do more research to explore possible unintended consequences.

MR. BIRD: Uh-huh.

MR. BERGSTRESSER: One of those possibilities was a survey. And I was wondering if you could elaborate on that, especially who the respondents of the survey might be, and how reliable you think -- or just sort of your vision for what the questions might be and what -- you know, a lot of times with surveys, you have sort of self-reported thoughts about what somebody might do in the future, and what kind of structure you would require for that to sort of be a reliable tool to use in the rulemaking.

MR. BIRD: Do we have the rest of the day?

(Laughter.)

MR. BIRD: Yeah, okay. I understand your question. You're asking about -- you start from the unintended consequences colloquy that Joe and I were having a moment ago. But you're really asking a broader question, I think, about surveys, about the feasibility of surveys, who should be surveyed in this context in particular, ideas for that, and questions to be asked. And I was not joking when I said do you have the rest of the day because there are just -- that's a really open question.

But let me, in an attempt to be brief, just say a few things about the question of surveys. And I want to also make clear that when I say doing surveys, I'm not just talking about going out and asking people their opinions of things. I'm also talking about going out and asking for factual information about what people do, how they do it, how often they do it, things like -- there are BLS and the Census every month conduct the current population survey.

We can put our heads together and design an entire monthly -- an entire supplement for one month of the CPS that would really provide some information here, I think. But it's not just about doing surveys. You can also do experiments. Now, one of the things I brought up in my comments was I have a whole section there where I'm really criticizing you about your cost estimations, where you've made assumptions about how many seconds or minutes or hours this, that, or the other job will take.

And I've said, hey, you know, who -- where did this come from? You know, and you don't really have where that came from. And there are all sorts of ways you can do better than just apparently pulling it out of the air or out of your own, frankly, limited -- your limited, my limited personal experience.

I'll give you an example, 60 hours for the average firm to develop its best-interest contract, 60 hours of lawyer time to draw up the template for the best-interest contract exemption. I don't know where you got that. I would like to know. But I could suggest, even without going -- and one thing you can do is go ask lawyers, hey, here is a kind of contract. I want you to fill these, and how many hours would you bill me to do it. Okay. That's sort of a survey approach.

Another approach you could take that might be even more feasible and cost effective within your capabilities is to go to your Department of Labor general counsel's office. You know, upstairs. And recruit three or four teams of three lawyers each, and say: "Okay, here is our plan for the best-interest contract, okay, and I want each of you, your teams, to go take whatever amount of time you need, and draw up a draft best-interest contract."

And each of your team results be submitted to another panel of lawyers from your general counsel's office and, you know, from your office, to evaluate how good they are, how much they fit what you want, and in the process, though, of the teams drawing up the contracts, they each keep up with their hours.

And so you wind up with an experiment, and an experiment that says, well, if you do it this many hours, you get a C grade contract. If you do it with this many hours, you maybe a B grade -- you know, there are some differences. So you would actually have empirical data to deal with. You know, 60 hours out of where? I don't know. I think maybe that's high, maybe that's low. I have no idea.

MR. PIACENTINI: So, Mr. Bird, Keith's question reminds me of a question I meant to ask you and forgot, which has to do with one of the surveys that we did rely on, which is a survey not that we conducted, but I think was right on point, that was conducted by the Government Accountability Office.

And I mentioned it, I think, in questions with the preceding panel. But GAO a few years back looked at employers' ability to understand and discharge their fiduciary duties under ERISA. So are they, you know, acting appropriately, understanding their obligations in running their employee benefit plans.

And they found that employers, particularly small employers, were very hard-pressed to understand and discharge those duties, and that they were particularly hard-pressed to find service providers that they can concretely know were in fact assuming and discharging those responsibilities to help them out. Or sometimes even to be able to discern whether the service providers were, in fact, assuming that status with respect to the plan or not and -- you know, if not, then what that would imply for their own potential liability.

Is that the kind of survey that you have in mind that would help us understand needs, and is the potential cost of small employers' difficulty in dealing with that something that we should build into our understanding of the baseline of the current regulatory system?

MR. BIRD: Okay. If I understand correctly, you're asking me a couple of questions. Or are you asking me to assess the survey that GAO did several years ago in the reports you referenced?

MR. PIACENTINI: Whether that approach, if, you know, surveying employers, asking about --

MR. BIRD: The employers, yeah.

MR. PIACENTINI: -- their ability to deal with, you know, the relevant regulatory regime --

MR. BIRD: And you're also asking me to -- the latter part of your question, you're asking me to --

MR. PIACENTINI: Should those be the types of costs that we understand as part of the existing baseline --

MR. BIRD: Okay.

MR. PIACENTINI: -- that currently it costs small employers something to --

MR. BIRD: Well, first of all, I have not examined in detail the survey instrument that GAO relied on. So I cannot speak to it in particular detail. I will say, however, that in general, yes, going out and asking questions of the people in the field that are affected by something --

MR. PIACENTINI: Okay.

MR. BIRD: -- is a great starting point. It may not be the end point, but asking those kind of questions, if you then look at the responses --

MR. PIACENTINI: Right.

MR. BIRD: -- and actually think about them, then other questions come to mind. That's the great thing about doing research. It's a full-employment program because every piece of research raises questions that lead to more research.

MR. PIACENTINI: I understand.

MR. BIRD: And, of course, I know obviously you have to at some point make some decision and take some action.

MR. PIACENTINI: So let me pick up briefly --

MR. BIRD: But -- but if you read carefully what President Obama has directed you to do, he's directing you not to stop the process right there. Once you've made a preliminary, a first step at a regulation or something, keep asking questions. Keep doing research. Go back and evaluate the results of what you've done so that you can say, oh, we went in the wrong direction, we went in the right direction, and things are fine, or we went in the right direction and we didn't go far enough.

So it's an iterative process. Knowledge is an iterative process, and you're in the knowledge business.

MR. PIACENTINI: Okay. So let me pick up on -- your other suggestion was experiments. And in fact, just in the last panel, we heard of an experimental approach to discern what might be, you know, the benefits or costs for consumers of dealing with advisors in the current regulatory regime. Is that another example --

MR. BIRD: And you're talking about Professor Schoar's --

MR. PIACENTINI: Yes, I am.

MR. BIRD: -- paper. And I have actually read her original paper that was based just on the Boston data.

MR. PIACENTINI: Yes.

MR. BIRD: And I picked up on the fact that when she was talking, she mentioned New York, too. And I though, I don't remember New York in what I read. And afterwards, I spoke to her a moment. And in fact, there is another paper about to come out where she has expanded on this and has the New York data also. And I'm looking forward to seeing that.

MR. PIACENTINI: Okay.

MR. BIRD: And, yes, that is the kind of thing. No, you shouldn't just pick up one example of a study and say, oh, we have the answer, this is it. No. That study, her study, is a step in the right direction. But it leaves a lot of unanswered questions. And in fact, one of the questions that's unanswered that occurred to me I proposed to her, standing right there. And she agreed that it was -- well, I won't speak for her.

But anyway, I posed a question, did you control -- did you control in your comparison between different kinds of advisors and differently-compensated advisors -- "Did you control for the individual advisors within your sample for the variations in their education, in their experience, in their training, and other factors?"

And she said she didn't. And she explained -- and now I understand why she didn't. She explained because this was a human subjects experiment. There were certain protocols, and she couldn't go either before or after and ask the people about this followup information.

But as she and I were talking, between us it came up -- but there is another way to have done that in that same experimental design that would have the -- have the mystery shopper ask some questions in the course of their programmed interview with the person, with the advisor, some questions about their experience and education and so forth, and that then becomes documented in the record. And then if you -- so if you -- yeah, her report, her study, is a good step in the right direction.

It's not the definitive result. And in fact, going back and redoing her study or expanding it would provide even more information that would be much better because there is a potential for what we economists call an identification/specification problem in her regression analysis.

And that is the -- because she didn't ask that question about the variation in education and training and so forth among the different advisors that were in the sample, then the value of the coefficient on whether you're potentially conflicted or not conflicted variable --

MR. PIACENTINI: Okay.

MR. BIRD: -- in there may be overstated. And it could be if you had the additional information --

MR. PIACENTINI: We're beginning to do a very, very deep dive now on one of the many studies cited in the RIA.

MR. BIRD: Yeah.

MR. PIACENTINI: So I very much appreciate that input, and I would very much welcome you to submit in whatever detail you want for the record on that. But I do want to make sure we have time for any other panel or this panel comments that might want to follow up.

MR. BERGSTRESSER: I just wanted to quickly go back to the surveys that we discussed, and just for the record mention -- because you mentioned potentially using a household survey to get more factual information. So I just wanted to --

MR. BIRD: You are going to be on about a five-year waiting list to get a supplement in on that.

MR. BERGSTRESSER: Right. And so we did utilize quite a bit of information from the survey of consumer finances.

MR. BIRD: Uh-huh.

MR. BERGSTRESSER: And I'm sure you're very aware because you did carefully read through our RIA. But I wanted to get that out for the record. And if you had additional thoughts about the --

MR. BIRD: Oh, absolutely. I'm not saying you didn't do any survey, or you didn't rely on any surveys. And I think the consumer finance survey is a very useful tool, and you used it, and I think generally appropriately. But there are some questions that just aren't answered by the available standard survey sources that are out there, like the CPS and the consumer finance survey, and the census, and all sorts of other things.

Frequently for regulatory purposes, you need very specific, very context-oriented information. And I have to tell you that, you know, I've heard the defense and the complaint. But we can't go out and do those surveys. We don't have the budget. Well, that's a question. Set that aside. And anyway, we have to go through this whole clearance process under the Paperwork Reduction Act to get a clearance from OMB to do a survey, and that just, you know, is a lot of red tape and rigamarole and, well, it's regulations, is what it is.

But actually, that doesn't cut it with me. I have experience right there. In 1991, I was doing support work for OSHA on a regulation that was addressing a very imminent public health problem. Okay. This wasn't about just people -- you know, this wasn't about whether or not people are getting 100 basis points difference on their rate of return on investments. This was about whether people were living or dying.

Okay. And so to get around the OMB clearance problem, we went out and collected what data we could because the regulations at OMB allow an agency to go ask nine questions to a given group of --

MR. PIACENTINI: Nine parties.

MR. BIRD: Not nine people, asking nine different respondents a set of questions without any clearance. And so in fact what we did on that, we went out -- this was a regulation that affected certain procedures in different industries. Well, I'll tell you. It was the blood-borne pathogens regulation in 19 --

MR. PIACENTINI: Needle sticks.

MR. BIRD: Yeah, in the late eighties, early nineties. And so it affected doctors' offices, nursing homes, hospitals, funeral homes, police Departments, fire rescue Departments, all sorts of people.

So we went out to nine -- selected nine in each category and asked slightly different questions to each nine tailored to their context. So we wound up actually getting 45 or 50 respondents sort of under OMB's radar, and to answer our -- there are ways if you want to --

MR. PIACENTINI: I understand.

MR. BIRD: If you want to really dig, there are ways. And then we got to analyzing those results.

But it turns out -- you know, the results of that initial survey of, you know, how many gloves do you use a day, how many this, what are your -- do you practice this procedure or that, you know, things like that. It didn't give a definitive answer because the answers were kind of all over the place. And so it was decided, you know, we really got to go into the field with a full-field representative sample of all of the doctors' offices, all of the fire and rescue Departments, all the prisons, all the mortuaries, all the hospitals, and so forth in the United States.

And so we set about to design a survey and to do the work with the OMB to get the clearance for the survey, and we designed the survey and got it cleared in four months. We took that survey into the field with -- I think it was 5- or 6,000 respondents, and hired a company to call people up and talk to them, and got their responses.

And I remember this clearly because after my children opened their Christmas presents on Christmas day 1991 -- and I left my home and went to the office and spent the rest of Christmas day running -- running SPSS progress, compiling the data results for that so that we can get it in. Within a year, we went from start to finish, and we had something that you can rely on.

MR. HAUSER: So we're going to need to wrap up this panel. But thank you all very much. And we'll compare notes, you and I, about holiday sacrifice for regulatory projects.

(Laughter.)

MR. HAUSER: Thank you all very much.

MALE VOICE: Thank you.

MALE VOICE: Thank you.

(Pause.)

MR. HAUSER: And now if we could have the next panel, please, Mr. Baily and Mr. Covington. And we just --

(Pause.)

MR. HAUSER: So I have an announcement. This is kind of akin to, you know, your lights are on and, you know, if you have driver's license such and such. This is somebody left their key at our front table. So if you're missing a key, it's out there.

I think this last panel, we just have two sets of witnesses, so do not -- we don't feel obliged to go, you know, to 1:15, but we will if you'd like.

MR. BAILY: I stand between you and lunch, right?

MR. HAUSER: Hey, well, ERISA is food enough for me, but others --

(Laughter.)

MR. HAUSER: Mr. Baily, whenever you're

ready.

MR. BAILY: Okay. I'm ready. Thank you for the opportunity. I'm impressed that you're doing four days of hearings on this. This is pretty grueling for you, and I appreciate the opportunity to talk.

The statement that I submitted to you was, I think, going to be a little bit more general than many of the comments that you've gotten that's talking about retirement issues more broadly. I'm not going to try, either here or in that statement, to do a point-by-point discussion of the DOL proposal. I hope the general comments are helpful to you. If not, we can finish quickly.

Okay. First statement, I think we have to recognize that the bottom third or bottom 25 percent of the income distribution is going to rely on Social Security for their retirement saving, you know, work with families, maybe what they accumulate in their house, continue to work beyond retirement years. Those folks are not going to save a whole lot. And so it would be nice if they would, but I think the fact is they're not doing so.

So we're really talking about the middle and upper middle income levels. The rich get advisors. I'm not sure we need to worry too much about whether those advisors are conflicted or not. If they're rich, they'll be fine in retirement.

So it's the lower middle and the upper middle we are most concerned about, making sure that they save enough and get the right kind of advice. And I want to say that based on what I've seen of studies, what I know of friends and anecdotes, a lot of people make bad mistakes about the investments they make.

There is a Wall Street Journal survey of Nobel Prize-winning economists and what they did with the money, and it was sort of like, oh, my goodness, why did they do that.

Okay. So the most important mistakes that people make are, number one, not saving enough; second, withdrawing savings prior to retirement -- and I realize under some circumstances, that may be necessary, but it's basically a bad idea -- taking Social Security benefits too early, which many of my friends have done; not managing tax liabilities effectively; and failing to adequately manage risk in investment choices.

And this last item, which I think is often neglected, includes those who are too risk-adverse and choose low return investments, as well as those that are overestimate their own ability to pick stocks and time market movements. These points are discussed in the paper I submitted to DOL in July.

I think they do indicate that retirement savers can benefit from good advice, even those with Nobel Prizes perhaps, but certainly for the rest of us and even those with good educations often don't make good decisions.

Turning to the market for investment advice, this is one where there is asymmetric information, which is a red flag for an economic market. It's going to be difficult to get optimum outcomes there, certainly not the only such market in the economy. I've had occasion to study the way doctors make decisions.

We also know the way lawyers, economists, all kinds of people make decisions. And they are affected by the economic incentives that they face. So I think there is -- it would be very surprising to me if advisors were not impacted by the different fees that they receive.

I'm familiar with the CA study. I know the authors of the CA study. I don't know if that amount is right, 100 basis points, but it may be in the right ballpark that that happens.

At the same time, I think if you have advice, people who can really encourage increased saving, and help save or select the products and good returns, create adequate diversification, they I think really will make their clients better off. That could be true even if those fees are paid to the advisors. So it's really a question, as I think you've said earlier, of the cost and benefits of this.

Okay. The implications of these general comments for the DOL's proposal.

First of all, on disclosure -- and I'm a supporter of the idea that we should have much better disclosure. A simple standard form given to all households receiving investment advice that lists the fees that they receive and tries to annunciate the extent to which those fees are affected by the decisions that actually -- excuse me, the recommendations that are made by the advisor. So if the advisor recommends this portfolio rather than portfolio, there should be a statement of how that would affect the advisor's fees.

Second, on small savers, I think there is a concern that complying with the rules as you have put them out currently may limit the number of people who have access to advice. I think there is some evidence from the UK that that happened. I know they're in the process of rethinking their proposal there.

So I think the DOL, you should be thinking quite hard about how you can simplify and maybe alter your proposal in such a way that you allow business models that can serve small savers to continue to exist, recognizing that there may be some fees, there may be some loss of return, but the saver is made better off anyway if they can get good advice. Obviously, professional standards are important there.

The DOL has been arguing that online solutions is a good way to go. And I think obviously over time we're all going to move more to online solutions. So I'm not against that. I do think at this point, though, it's a stretch to say, okay, small savers should use online solutions. I'm sure there are good ones there. There are probably bad ones there.

But I also think there is a certain amount of face-to-face or personal interaction that may be needed to guide people to make the right decisions. They don't pull money out. They don't get panicky when the market goes down, and so on.

One of the recommendations is that savers use myIRA. That I looked at and did some calculations on. It's a pretty low return option. It's not one that I would personally use or recommend to anybody that I knew. Maybe towards the end of one's life one doesn't want to take any risk. That's a good option. But I think for saving for retirement, if you're 20, 30, 40, you would want to take more risk or more diversified portfolio.

I think there is some clarifications about education versus advice, and I talk about that in the paper that I submitted. Can advisors give advice without necessarily triggering fiduciary responsibility? And I think again, think about the line between education and advice, and how to discourage advisors from sharing information in a way that leads to future conflicts of interest. So try to standardize maybe some of the information that's provided.

And then finally, I mention the implications for risk management. I sort of talked about that already. I think young savers certainly, if you look at the return to equity over the last 200 years, it has been substantially higher than the return to risk-free bonds.

We don't know what is going to happen over the next 50 years or 200 years, but certainly it suggests that you would like to have some equities in your retirement portfolio. Maybe for young people, it would be predominantly equities, and then as you reach retirement, you would move more into bonds. Or, well, there is still often a long period from first year of retirement to death.

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

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

MR. HAUSER: Mr. Covington.

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

IRI is the only national trade association that represents the entire supply chain of the insured retirement income industry. Our members include major life insurers, banks, broker-dealers, and asset management firms, and are represented by over 150,000 financial professionals serving 22-1/2 million American households in communities across the country.

I appreciate the opportunity to share our perspectives about the impact of the proposal on Americans who use and need guaranteed lifetime income products. And I want to take this opportunity to share particular thanks to the Department, to you, Tim and Judy and your entire time, for meeting with us and our members after the rule was released and prior to this hearing. We found those discussions to be very productive and constructive, so thank you for taking time to do that.

The administration, including the DOL, as you know, has done more than any administration before it to increase Americans' access to guaranteed lifetime income. And we know the Department shares our goal of ensuring that this rule does not undermine those efforts. To that end, we provided a detailed comment letter requesting changes to the proposal to adopt a best-interest standard for financial advisors without making it harder or impossible for people to use annuities to plan for a financially secure retirement.

Today, I will briefly discuss the benefits that annuities provide, and then I will share some key findings from our study Deloitte and Touche conducted for us on the likely operational and market impacts of the proposal in these highly valued and needed products. In particular, I will explain why we believe the BIC exemption is unworkable for variable annuities, and why PTE 84-24 is the only viable way to continue to make VAs available to the majority of Americans.

So the benefits of annuities. As we all know, Americans today are living longer than ever before, with a married couple of 65 years of age having an over 35 percent change of one of the spouses living to be age 95 or older. Access to defined benefit plans we all know have plummeted, and healthcare costs continue to rise.

As a result, over 30 million baby boomers and half of Gen Xers are at risk of outliving their savings. Outside Social Security and private pensions, annuities are the only products that can provide guaranteed lifetime income to help retirees ensure they will not outlive their savings.

Based on the principle of risk-pulling, annuities enable individuals to shift the uncertainty about how long they will live to an insurance company, who then spreads that risk among all of the annuity owners, all of its annuity owners. In addition, annuities offer a guaranteed feature no other financial product provides, such as insurance guarantees to protect investment values during market downturns, and principal protection in the form of fixed investment options.

So here is a real-world example of how these features help consumers during retirement, even in the face of adverse market conditions. A client of one of our member companies retired with about $500,000 in savings, but substantially depleted her assets by 2005. Her advisor recommended putting $150,000 into a variable annuity, with a lifetime income guarantee. Her account value dropped by about 20 percent in 2008, but her guaranteed monthly payments were not affected because they were guaranteed based on the initial investment, regardless of market performance.

As a result, she did not have to make the difficult decision so many others had to make in 2008 to either reduce her withdrawals and with that her standard of living, or to maintain her withdrawal amount and run the risk of running out of money.

You know, unfortunately, only 1 percent of the more than 50 million Americans participating in employer retirement plans have access to annuities. And I know the Department is working on that, meaning that the only way most retirement savers can obtain guaranteed lifetime is through purchasing annuities in IRA rollovers.

Given the benefits of annuity ownership, the four documents ruled the Department should fully evaluate the impact of any rule on the access to guaranteed lifetime income products. These benefits show why the administration's work is to increase access to annuities is so important, and why 13 Senate Democrats sent letters to Secretary Perez last week urging the Department to assure the rule does not negatively impact Americans' access to retirement income products.

Unfortunately, the rule proposal as currently written would make it even harder for most Americans to obtain guaranteed lifetime income, but we of course know that that is not the Department's intent.

So in this regard, I'm going to focus on the proposed -- proposal to remove variable annuities from PTE 84-24 and instead permit VA sales only through the best interest contract exemption.

We believe, based on our internal analysis, feedback from our members, and our Deloitte study, as well as the testimony of several witnesses yesterday, that the BIC is just not feasible for variable annuities, and that the Department should restore VAs to the scope of PTE 84-24.

It's important to emphasize at this point that 84-24 already requires financial professionals to charge only reasonable compensation, and the proposal would layer a best-interest standard on top of the existing conditions, which we fully support, as you know.

Now, turning back to the BIC, even if the Department adopts our requested changes, including refining the definition of best interest and reasonable compensation, insurers would still have undertake extremely extensive, costly, and time consuming changes to people, processes, and technology, just to determine the applicability of the BIC to particular transactions, not to mention the systems and process changes needed to comply with the complex requirements of the BIC.

According to the Deloitte report, these changes would involve massive information technology redesigns and buildouts that would likely take several years to complete. The report also indicates that the necessary systems and process changes to implement the BIC may be economically impractical for some smaller insurers, leading some to exit the retirement business, and thereby reducing consumer choice and access.

Moreover, the Deloitte report found that the BIC does not provide sufficient clarity as to the requirements and responsibilities of insurers, making it difficult to fully assess the costs and challenges associated with operationalizing the proposal. Due to this uncertainty, our members are still working to evaluate the exact changes that would be needed, and the cost of those necessary changes.

It is instructive, though, to consider the findings of the study conducted by Deloitte for SIFMA, which found that it would cost large and medium broker-dealer firms approximately $5 billion dollars just to put in place the systems necessary to comply with the proposals, and a billion dollars in the aggregate on an annual basis ongoing.

Removing VAs from PTE 84-24 would have a significant adverse impact on consumer access to these products. Despite this reality, the Department's regulatory impact analysis did not consider all the challenges of BIC compliance for -- of BIC compliance for insurers. These requirements will ultimately decrease consumer choice regarding lifetime income.

We believe the impact of removing VAs from PTE 84-24 far outweigh the potential benefits this change might have. In fact, given that PTE 84-24 would include a best interest standard and a reasonable compensation requirement, along with existing SEC and FINRA disclosure requirements that achieve the transparency goals that the Department has, it's unclear exactly what consumer benefit is achieved through this proposed change.

Fortunately, there is a simple solution, as I already indicated, if the Department should restore VAs to 84-24. This exemption has been in place for both variable and fixed annuities for over 30 years, in recognition of the fact that all annuities are insurance products that provide guaranteed lifetime income, and by all accounts has effectively protected consumers throughout the past three decades, while at the same time facilitating the sales of all types of annuities.

With the addition of a workable best interest standard, we believe it can continue to be a viable path for consumers to access these valuable products while achieving the Department's goal of enhancing consumer protection.

So thank you for the opportunity to provide input to help the Department understand how the proposal would inadvertently create new barriers to Americans' access to the only products available in the market that can provide a source of guaranteed lifetime income.

Happy to answer questions, and again thank you for the opportunity to be here.

MR. PIACENTINI: Okay. Thank you to the panel. I'd like to start with a couple of questions for Mr. Baily. So if I understand your testimony and your comments submitted correctly, you have two concerns. Well, maybe more than two, but let me just mention two. One is that compensation arrangements and economic incentives can influence an advisor's behavior.

MR. BAILY: Uh-huh.

MR. PIACENTINI: And perhaps do. Another, though, is that too heavy-handed a regulatory approach could compromise access to advice for maybe smaller --

I guess you would say lower and middle savers.

MR. BAILY: Right.

MR. PIACENTINI: So I guess my question is can you comment a little bit on how you would reconcile those two? Is it your view that we would have to tolerate some degree of conflict in order to give access to these lower and middle savers, or should we be seeking, and is there a way, and is our proposal coming close, to mitigating those conflicts, and at the same time preserving access to affordable advice services.

MR. BAILY: It's a very good question. I think it's really important that people get good advice. So if it's necessary to face a certain amount of conflict of interest in order to do that, I would do it.

MR. PIACENTINI: But is it good advice then, you're selling good advice?

MR. BAILY: Provided that's good advice. So there clearly has to be the right fiduciary standard. I also mentioned disclosure, and if the disclosure -- I know there is some skepticism about whether disclosure works or not. But I think if you could try to simplify the disclosure, and so that it really says, okay, if you -- if you buy this product, there is going to be a 5 percent load fee, so that every $100 you give me, only 95 goes into the saving account.

So I think, you know, my concern is actually that would discourage a lot of people from seeking advice. But, you know, I think they should know that that's the case. And I have maybe more confidence than you guys have in whether that disclosure can help because I don't think you're dealing, as I said, with typically the poorest people in our society.

I would -- it would be nice if we could completely eliminate conflicts of interest. And I think there are certainly ways of minimizing it so that if you can -- you know, there are people who are giving advice who are really not conflicted. And actually, if you have a load fee, you pay that upfront, and then after that, the advisor suggests which funds you go into. He or she doesn't necessarily have a conflict there about which fund to go into.

So I think there is scope for your regulation to really minimize the amount of conflict that's being faced. And I apologize if I'm not more specific about exactly how you would do that, but I think by a process of a) disclosure, and b), you know, favoring certain kinds of -- trying to avoid those decisions made by advisors that would be the most compromised.

MR. PIACENTINI: Okay.

MR. BAILY: But I would be willing to settle if you could get good advice for even a little conflict. I sort of feel that's life, and you get that in any field.

MR. PIACENTINI: Understood. And I understand your preference for simple disclosure, and the example you gave there was a simple way of describing a one-time, single expense, and compensation to the advisor.

But I think that, you know, we're dealing with an environment where often the compensation itself and the expenses themselves are not that simple. There may be a load, but often, unlike the scenario you described, it doesn't -- it isn't determined before you select which fund, right? Different funds will carry different loads.

MR. BAILY: Yes.

MR. PIACENTINI: And different funds will pay different shares of that load to the advisor. So that it's going to depend. And then there may be other pieces to it. There may be 12B-1 fees. There may be revenue sharing that -- the economic analysis goes into a lot of the different -- so I guess my question is, in the presence of some complexity, is it your view that maybe some sort of a generalized disclosure -- I mean, the kind of disclosures you see now in practice say things like, my fees may vary depending on your decision.

You know, we do receive compensation in these various forms from these various products. But they don't tend to get down to the details. Is that effective?

MR. BAILY: I would -- no. I would like to see a disclosure that gets down to the details. So I would like to actually have the person receiving the advice --

MR. PIACENTINI: But then could that be simple?

MR. BAILY: Okay. You can only go so far. So there is a trade-off, all right?

MR. PIACENTINI: Sure.

MR. BAILY: You're going to make it as simple as you can --

MR. PIACENTINI: Right.

MR. BAILY: -- consistent with trying to minimize the amount of conflicting incentives facing the advisor. So that's a choice that you have to make. What is the trade-off there?

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

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

MR. BAILY: Right.

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

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

MR. BAILY: That's a good point, and not one that I recognized in my written comments. And I appreciate your pointing that out. I do think, though, that this is just an enormous challenge that we face. I mean, there is a little bit of a rosy glow in the rearview mirror about how many people actually have defined benefit plans in the old days. It was actually a restricted group. Not everyone had them.

But the truth is that, you know, most of those are going away now. And so we've got Social Security, but it's a pretty minimal program. So I think there is this urgent need that we have that people have to save for retirement. And they've got to decide to make that saving, and they've got to invest in a sensible way in order to supplement what they're going to have at retirement.

So I'm really sort of looking for anything that will allow the market to provide advice on a broad basis. To the extent that you feel that the tax incentives have already been built into the system, then I think that's great. But it is something that I think should be monitored. And also, we can get the evidence from other countries, not just the UK, of how they have proceeded, and what that has done.

I know in many countries in continental Europe, for example, people just put money in savings accounts, and that's okay. But it doesn't get you very far to a retirement fund.

I did a study some years ago, was part of a study, that tried to answer the question, Americans save so little compared with, say, Germans or other people, but we're much richer than they are. Now, that's on average. Obviously, that's weighted towards the very rich. But it's still the case that most continental Europeans earn negative real rates of return on their retirement savings.

So I think we do need to try to face this challenge and get that advice. And, you know, one could maybe do it on a government program, but I don't know that that's feasible. So we've got to find a way to take advantage of good investment advice and incent (sic) it in the right ways.

So that's just sort of my spiel, but --

MR. PIACENTINI: Okay. So maybe that's a good segue then to talk about lifetime income products a little bit. You know, I do understand the challenges that have been described by Mr. Baily. And I understand how lifetime income products are, you know, intended to address some of these very difficult problems. But they are difficult problems, and so I think that the approaches themselves carry their own challenges.

So from the Deloitte report that you referenced, and which is very helpful -- thank you. One of the things I picked up in the report, it said that one of the reasons why this is challenging for the industry is that compensation and fee data is sometimes fragmented or not captured, and therefore would be costly to collect and integrate. I'm paraphrasing a little bit, but I think that's a reasonable summary of one of the major points in the report.

I guess my question is, if that information is fragmented, does that create -- and how does the institution then monitor how all of the different fee and compensation arrangements are influencing what is happening down the distribution channel?

And, you know, you said you're in favor of a best interest standard.

MR. COVINGTON: Uh-huh.

MR. PIACENTINI: But if we don't have data, if the firms themselves don't have the data, how could you see whether these different financial arrangements are in fact in effect being consistent with the best interest conduct by the sales channel?

MR. COVINGTON: Uh-huh.

Well, I think that what we have to look at first, is the current regulatory scheme and the requirements on insurers that are offering these products that require multiple levels of review to ensure that these products are suitable, both from a state perspective, from a FINRA perspective. You know, these products -- when these transactions occur, I think they may be the only product that has this level of review by both the financial advisor, then by a registered principal.

And then there is also red flag reporting that's required, both by FINRA and by state insurance eligibility requirements that require a company to have a system of supervision in place to assure -- have reasonable assurance of compliance with the law.

Frank, do you have anything to add to that from the Deloitte report?

MR. O'CONNOR: Yes. I think just speaking about collecting and cataloging and analyzing the costs and the commissions and things like that. You know, a lot of what was pointed to by the working group that contributed to that report were things like revenue sharing that occur that are not necessarily today split out, and are very difficult to account for at an individual level. That and then the nature of some products is to have those costs actually embedded in the product as opposed to being explicit.

So it creates a very challenging system and data collection problems for the companies to deal with.

MR. PIACENTINI: So if those costs are not separately captured, how you can monitor what effect or relationship it might have or not with what is going on in a sales channel?

MR. O'CONNOR: Well, I think the answer to that is really tied to looking at products in the aggregate. You know, the -- if you think about what the Deloitte report is designed to do and what we asked them to do, was to really put together a working group, have them tell us, or tell us through the report, where they think the challenges are going to be in terms of creating the disclosures that are going to be required.

So in that, what we have is a report that details those challenges, but if you're kind of talking then about how do they know, you know, what is going on today, I think that would be really an aggregate, you know, type of thing. So for this product type, you know, these are the costs, and this is what happens, and these are how they sold, how they are sold.

MR. COVINGTON: Yeah. I would also add, in terms of the red flag reporting and the system of supervision that's in place at all firms today, that they undertake to look and see if there is a concentration of one product being sold over another. They even get down to the advisor level to see if a particular advisor is selling one product or another. So that's one way that they're monitoring those incentives today and ensuring that suitable recommendations are being made under today's regulatory requirements.

MR. PIACENTINI: So it's a monitoring of what is being sold against the suitability standard. But that's not exactly the same as monitoring of --

MR. COVINGTON: Well, it's a monitoring of concentration of sales by product. And so I think one of the things if you -- if a supervisor in a firm saw some concentration, they'd be -- they would then follow up and ask questions as to why are you selling this product. Now, many times what they find is there is a particular feature that they use for particular situations that a particular company is providing. But that is something that's an ongoing basis that the compliance systems do detect.

MR. PIACENTINI: So let me ask one -- I think it's a related question, but it actually appears as a separate point in the Deloitte report. There is a point made a few pages later that some product fees are difficult to quantify or communicate to customers. And, you know, Mr. Baily made the point earlier that, you know, disclosure perhaps could be helpful if it's simple.

So I guess my question is, if Deloitte is documenting that some fees are difficult to quantify or communicate, do you have a view about whether those things can be effectively disclosed to consumers for their use in decision-making? And how is that done?

MR. COVINGTON: Well, I think one of the things that the report, the Deloitte report, is talking about fees that are embedded in the product structure. And so those are difficult, and there is questions as to whether those can be disclosed. But if it's embedded in the product in a spread type product, there are challenges around that.

Frank, do you have anything to add to that?

MR. O'CONNOR: No. You stated --

MR. COVINGTON: Yeah.

MR. O'CONNOR: Exactly right.

MR. COVINGTON: Yeah. So when they talk about that, that's not -- I mean, that's a small -- if you were to look at it in terms of variable annuities versus fixed annuities, you'd see that more on the fixed annuity side.

MR. PIACENTINI: So consumers then frequently are sort of challenged with the -- that they need to make a good decision, but they need to make it without complete, detailed understanding, without, you know, available information even on exactly what the fees are and what is attached to which product feature and so forth, because as you said, they're sort of in this spread, and so you can't really --

MR. COVINGTON: Well, those are -- I mean, that would be inherent just like in a banking product and any type of fixed product. They can look at the marketplace and see what is available in the marketplace. And financial advisors routinely will see, okay, what fixed rate can I achieve for -- you know, for my client.

And so they're really looking at that end result of what is the rate of return that can be garnered through this product, just like a bank CD which you can look at in the open market.

MR. PIACENTINI: So would it be fair to say then that the consumer really is relying on the advisor, the sales agent, to help them make a good decision around fees maybe that they can't directly evaluate themselves?

MR. COVINGTON: Well, I don't know that I would agree with that, with that characterization. What they'd rely on the advisor to do even their own research is to identify for those types of products what range is available in the marketplace from the return standpoint.

MR. PIACENTINI: Okay. Thank you.

MR. HAUSER: I had intended to bring the Deloitte report with me, but did not. So let me just go from memory. But my recollection is that -- I mean, Deloitte's role here was really to kind of aggregate and collect the input they got from members of your organization, essentially. And they have a fairly, you know, substantial disclaimer about, you know, that they're just passing along what you got.

Nevertheless, your report is very helpful in the sense that it identifies these various processes. But what would be very helpful to us, I think, as we move forward with this project is: to the extent you can actually, you know, provide a little more granularity about what the costs are of the various components of the project and, you know, to the extent there are different views from different firms. If you could give us that.

You know, anything you can give us in the way of underlying data and a little more specificity about which feature is costing what would be enormously helpful.

MR. COVINGTON: Yeah. We'd be happy to do that. And let me emphasize that, you know, Deloitte did what we asked them to do. You know, their role was to meet with our member companies to start the process of surfacing the details around the operational impacts that our member companies have identified.

And, you know, as we started this project, we thought there was no better source for this information than the operational professionals who are charged with developing, billing out, and managing the processes to operationalize the proposal. But, of course, we would be happy to provide, you know, any detailed information around questions that would be helpful to you.

MR. HAUSER: So as I understand you, you know, 84-24 as amended would incorporate these kind of fiduciary norms, the best interest standard and the like. And I think if I understand you, you think that's workable. Is that right, for your industry?

MR. COVINGTON: Well, I mean, obviously it's a great starting point. I mean, we have comments related to the definition of fiduciary. But in terms of the exemption, we believe that insurers and broker-dealers should be able to operate both under 84-24 and the BIC. So our comment letter does detail requested changes both to 84-24 and to the BIC to address those -- to address both the best interest standard and the reasonable compensation requirement.

MR. HAUSER: And as you think about it, what are the big -- you know, the key differences between -- or maybe the key cost drivers as between the BIC exemption and 84-24 that are causing you concern about the feasibility or workability of the BIC exemption?

MR. COVINGTON: Yeah, well, there is two parts, right? I mean, there are the regulatory requirements, and as these are blended together in the operational impacts. And so each part of the proposal would impact the operationalizing the proposal.

So there are -- obviously, there are parts of it that are related to the fiduciary definition and identifying when somebody becomes a fiduciary. And then there are parts -- obviously the contract requirements, who has to be a part of the contract, when does -- you know, all the issues that we talked about over the last day around the contract, the disclosure requirements, and the challenges related to that.

So those are around the -- you know, those are the key requirements from an operational standpoint. From a regulatory standpoint, obviously we talked about the best interest standard without regard to language that is currently in there, and the reasonable compensation requirement that is tied to the value of the services that are provided, but don't take into account the fees that are associated with the guarantees that are provided by variable annuities.

And those are -- there are other -- you know, on page 35 through 51, but I would say that those are the major provisions, and in addition, what we see as problems in the current proposal around proprietary products.

Again, we know that it was not the Department's intention to forbid or to prohibit commissions on these products. We know that the Department wants to be able to -- wants companies to be able to provide proprietary products, just under the current BIC. It just -- we just -- all the experts who have looked at it have indicated that it doesn't work for commissioned-based products as it's currently drafted.

MR. HAUSER: And why is that?

MR. COVINGTON: Because of the -- because of the provisions that --

MR. HAUSER: One in particular.

MR. COVINGTON: Well, one of the provisions, it talks about the level of services that are provided, and all the examples that we see go to fee-leveling. And I know that's not the intent, but that's what the examples say, and there is not enough clarity in the reasonable compensation requirements to give people assurances that commission-based would be permitted.

MR. HAUSER: I see. So, you know, maybe echoing a bit a question I asked yesterday of SIFMA, but:

Suppose that we resolved your operational concerns about the disclosure issues, data retention, and the like under the BIC, that instead of using the "without regard to" language, we just used the, you know, 404(a) language about exclusive purpose, that we made it completely clear that you can sell proprietary products. And we gave you guidance on what those circumstances would be. You know, that the advice would be prudent, the fees in the aggregate would be reasonable in relationship to the services and the product, you know, being sold, that there is nothing materially misleading in the communications to the customer. That you give full and upfront disclosure about fees and conflicts, and that you don't incentivize your sales force to act in a way that runs contrary to those precepts.

And that you put all that in the contract, and that's it, that's the proposal, and that's your only obligation. Essentially execute a -- you can get these commissions, you can get the standard arrangements, but you're going to make a contractual commitment to your customer to adhere to these fiduciary norms.

Would that present, you know, significant workability issues? Is that something that would be feasible? And if not, why not?

MR. COVINGTON: Well, that's a lot to assume. I certainly think that those concepts -- and concepts are a very good step forward. And we'd be very open to, you know, seeing language around that and determining whether those are workable.

One thing I don't know that you mentioned -- you may have, Tim, but I may have missed it. And again, maybe you did. But I want to emphasize that the reasonable comp requirement we believe should mirror the reasonable compensation provisions in 84-24 to take into account the fees that are associated with the guarantees that are provided by the product.

MR. HAUSER: Right. And we -- and nobody should think that we're -- you know, that we don't think you should be able to, you know, price those guarantees and take those into account in making a recommendation.

MR. COVINGTON: Yeah. And I'd also note again, conceptually that would be a very big step forward. We'd be very interested in having further discussions with you about how -- what that would look like. There are also comments in our comment letter related to the definition of fiduciary that we believe take into account, you know, more typical marketing service and sales activities, and we detailed those comments. We won't go into detail about those today, though.

MS. MARES: So, Lee, I have a question for you. And we were talking about the ability of consumers to understand what they're paying for, what they're buying, in a product like a CD. The terms and conditions of a CD are pretty simple, so you could call up a bunch of banks and say: what are you going to pay me for a three-month, a six-month, and a nine-month.

When you look at an annuity, that is a contract where the terms and conditions of the contract may vary. Is there a mechanism in the marketplace today where a consumer can in fact shop, comparison shop, fixed annuity, for example, like they can a CD?

MR. COVINGTON: I'm going to refer to Frank on this. I think I know the answer to it, but Frank is probably more authoritative on this.

MR. O'CONNOR: Yeah, there are certainly sources for that information, and some of those are web-based, where you can put in an amount that you want to invest and see a series of different fixed annuities and what their current rates are. So there is a fair amount of transparency around that.

MS. MARES: And those fixed annuities would have a standard set of terms and conditions?

MR. O'CONNOR: Not necessarily a standard set of terms or conditions because the crediting periods may vary, you know, for the guarantee. I shouldn't say the crediting period.

The guaranteed rate, you know, may be five years in one product and seven years in another product, or three in another. But when that information is presented, those pieces of information come a long way to that. And then there are even calculations that are done that do something that, for lack of a better phrase, would be called yield-to-surrender.

So you know, what is that product going to credit over the period of time that you might have a surrender charge, or over the period of time it was guaranteed, and that levelizes that across products.

So those things -- those types of things are out there for comparison.

MS. MARES: Thank you.

MR. HAUSER: And then two questions, one following up on Judy's, but I'll take that second anyway.

The first question is yesterday I asked somebody, maybe Professor Finke -- you know, we had proposed -- we hadn't proposed actually. We had asked whether there was -- would be some value in coming up with some version of a streamlined safe harbor for some, you know, set of products that are fairly simple, that are low-cost. We can't imagine the conflicts of interest are what's driving the recommendation for these products. And nevertheless, they're good investments for people.

We had huge operational issues of figuring out how to make that work. But it occurred to me in talking, you know, about these insurance products, would there be some sort of, you know, streamlined safe harbor that one could construct for some particular, you know, lifetime income product that would make sense?

You know, if you're offering this particular lifetime income product, if it adheres to these features, you just have an exemption. You don't need to worry about the Department of Labor. You don't need to go through all that -- you know, a lot of the conditions that are available otherwise.

Is that something you have thoughts on? Whether that can be made --

MR. COVINGTON: That's a question we have not considered. I'd be happy to go back and talk to our members about that. But we haven't had discussions about that.

MR. HAUSER: Yeah. It's not necessarily part of this project.

MR. COVINGTON: Yeah.

MR. HAUSER: But it just strikes me, if we want to encourage savings, and if we want to encourage in particular people to annuitize when they seem to have behavioral, you know, impediments to doing that, that's something worth thinking about. And I'd certainly welcome your advice, if you have some proposals along those lines.

MR. COVINGTON: Sure.

MR. HAUSER: And then maybe following up on Judy's questions, so would there be some way to construct a meaningful disclosure for the customer benchmarking based on the kind of data sources that, you know, Mr. O'Connor was just describing to Judy, or is that just not doable?

MR. O'CONNOR: When you say benchmarking, just to clarify that, so you would think of that as, you know, an aggregation of those -- that type of information --

MR. HAUSER: So I'm recommending -- right. I'm recommending this particular product. Here is how it lines on various, you know, salient -- various important attributes compared to, you know, this data source.

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

MR. HAUSER: Thank you.

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

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

And Europe Economics also did a report in 2014 which showed that, on net, new clients -- there is net increase in new clients that are coming to advisors for the advice. And also the transparency that is contained in the legislation that requires advisors to notify investors about how much they're actually paying for the advice is actually having good results in terms of the marketplaces developing better products, and fees are actually going down.

So I just wanted to know what your thoughts were to that. And also, you said that they were reconsidering their proposal, so I was wondering what you were referring to when you said that.

MR. BAILY: I worked my way through the very lengthy report on the UK and read a number of critiques of it, was left feeling that I didn't fully understand one way or the other.

I thought there were some -- clearly some benefits that had been achieved by the standards by doing the kinds of things that you're describing. I think there was some evidence that there had been a drop in the number of people receiving advice, and that's one of the things I was referring to. So again, I think there were some pluses and minuses.

In terms of reconsidering, this is just a news item that I read, that the UK is taking another look. I believe it's the Treasury, but -- and I should have checked before coming in here this morning, but I believe -- this afternoon rather. But I believe that it's sort of taking another look at these proposals and seeing if they need to modify them.

But overall, I'm a big fan of learning from what other countries do. And I actually wrote a book some years ago looking at different retirement plans. And it's really interesting to see how they vary, how individuals respond to those variations. And I had mentioned -- by the way, I have avoided talking about annuities because I don't want to give you conflicted advice. I am the director of an insurance company that sells annuities, but -- so you can discount what I'm about to say on that basis.

But I would say a) that our annuity products are regulated quite heavily already, in our case by Connecticut and New York. And annuities generally are considered to be a pretty low margin product. So, I mean, maybe there is more efficiencies that can be gained there. But this is a little bit like airlines. People complain about airline fares, but over multiple years, airlines generally have been a money-losing operation. So I don't know that we're going to expect to get much lower fares and still have airlines in business.

So I think my perception of the annuity market is that it's one with pretty thin margins. So maybe we can get better annuities. Maybe we can get better disclosure of annuities. But the notion that somehow those aren't going to be -- there is going to get much lower fees would have to deal with the fact that these are low-margin items already.

MR. HAUSER: So do you have any thoughts on the idea of coming up with some kind of, you know, special safe harbor for, you know, particularly unconcern-worthy -- I couldn't think of the word -- you know, annuity?

MR. BAILY: I think that's a proposal that's really well worth looking into, that gives the suppliers a safe harbor. I do think different clients will want different kinds of products, so, you know, we maybe created safe harbors on the mortgage side, and there are pluses and minuses to that. But I think it's probably helpful to have qualified mortgages and so on. So I think that's something that I would support you looking at. I don't know if it's part of your charge.

MR. HAUSER: And then everyone can go because this is about a different project. But since you're here, what --

MR. BAILY: What are you going to do to interest rates?

(Laughter.)

MR. HAUSER: No, no. Do you have any thoughts on other ways -- I mean, we get a -- well, the advice we tend to get in connection with this project is the best -- is you should promote savings by permitting lots of conflicted advice. But moving out of that space, do you have any suggestions on other ways we could do a better job of promoting retirement savings or other initiatives we should be thinking about? Big question, and it's okay if you don't --

MR. BAILY: It has proven very hard to think of ways to increase savings. I served in the White House under Bill Clinton, and I know Bob Rubin was very frustrated with us economists because we kept telling him this and this proposal probably won't do much to increase savings. So it is a really hard problem to get that, certainly. You know, education I think plays a role, having people understand what they will really need to achieve the goal of having a sufficient cushion.

I mean, this may be a little bit off in space, but George Bush proposed privatizing Social Security. In other words, he wanted people to invest in private equities and bonds and hold portfolios. And that fell apart partly because I think it's a bad idea. I don't think we should privatize Social Security, and partly because -- actually, when he went to the investment community, he said, we want you to manage this stuff for 30 basis points, and they all said, no, we can't do that.

So but I do think that there might be something that would be a sort of add-on to Social Security, so that those who wanted to, and maybe with an opt-in/opt-out provision, that you would automatically get enrolled in a supplement to Social Security, which would be invested in maybe a bunch of default options on investment.

I don't think that's going to happen any time soon, but you're asking me for suggestions, and that was one that I have made in the past.

MR. COVINGTON: And, Tim, you won't be surprised that I'll take this opportunity, since you asked the question, we think that the Department should move forward with its rule to require employee benefit -- retirement benefits plans to provide a lifetime income disclosure. And our research shows that --

MR. BAILY: Absolutely.

MR. COVINGTON: -- investors will -- first of all, 90 percent want that information, 90 percent find it would be helpful, and over 75 percent would increase their savings by 4 percentage points, 4 to 6 percentage points, more. So we would encourage the Department to move forward with its rulemaking on that.

MR. O'CONNOR: Okay. So I hate to go from the big picture back to the narrow, but this did -- some of this conversation brought to mind one piece that I think that I'd like to try to just clarify for the record.

And I honestly don't remember whether it was this panel or maybe the ACLI witness from the preceding panel who pointed that, you know, we have surrender charges. But after the surrender period, they said, you know, "the consumer buying doesn't really pay any commission out of pocket, right?" And then after the surrender period, I think there was a representation made, well, then there is -- if you get that far, then there is no commission that you have to pay.

And this in some sense was inspired by the reference that annuities are a low-margin business. I mean, part of what is making them a low-margin business is that they have to pay some amount of commission, which may or may not be the efficient level, but that's a part of what is making them a low-margin business, is paying that.

But anyway, my narrow question is just I think it's the case that if I hold an annuity past the surrender period, that it may be there is still some margin there that's being thrown off that is helping to defray the commission expenses. That is to say, commissions aren't paid entirely from surrender charges of people who surrender early, are they? I mean, some of it comes from other places.

I mean, whether a particular consumer ends up out of pocket for the commission that was paid to their agent sort of depends on a lot of things, right? They may end up -- as in your example, you know, maybe the insurance company lost money on them, right, because they protected them through a downturn.

But it's not just a question of the surrender charge, is it? I mean, there are -- commissions come out of all sorts of pieces of the annuity, I think.

MR. O'CONNOR: Yeah. I mean, that's fundamentally true. You know, a variable annuity has a mortality and expense charge, and a portion of that, a significant portion of that, is actually offsetting the cost to the insurance company --

MR. PIACENTINI: And that's an ongoing charge.

MR. O'CONNOR: It is an ongoing charge. And that has several purposes. It's called a mortality and expense charge because it covers mortality risk, and it also covers some of the insurance company's expenses, not just commissions, but also administrative work and support, ongoing support provided through call centers or what have you, so --

MR. PIACENTINI: Okay. Thank you.

MR. HAUSER: Thank you very much.

MR. BAILY: Thank you for having us.

MR. HAUSER: Thank you.

MR. BAILY: We appreciate it.

MR. HAUSER: Okay. We're back at when, 2:15? 2:15.

(Whereupon, at 1:01 p.m., the public meeting in the above-entitled matter was recessed, to reconvene at 2:15 p.m. this same day, Tuesday, August 11, 2015.)

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

(2:15 p.m.)

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

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

Mr. Derbyshire?

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

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

Let me begin by saying that Fidelity fully supports a best interest standard for investment advice. Our concern, however, is that the rule as proposed is unworkable and would prevent firms like Fidelity from providing the assistance that our customers ask for and need in preparing for retirement.

In our written comment letter, we've detailed the many reasons why the proposal is unworkable. But given the Department's commitment to move forward on the proposal, I'd like to use my time today to outline a solution that we believe offers a simple, straightforward, and viable alternative. And the solution is directed at two fundamental problems with the rule.

The first fundamental problem arises out of the rule's attempt to mitigate all conflicts of interest in the provision of investment advice, including the perfectly normal and acceptable conflict of interest that exists in every commercial relationship between a buyer and a seller. Buyers and sellers are by definition on opposite sides of a transaction, and like every seller, a financial services provider has an inherent conflict with respect to the terms and conditions of its own engagement.

This is true even for fee-based advisors, who have an incentive to maximize their fees and who will only receive their fee if they can convince the investor to hire them.

So the central problem with the definition of investment advice as proposed is that it fails to take into account this basic concept, and it's so broad that it makes an advisor a fiduciary with respect to the establishment of its own services and compensation. In other words, the definition of fiduciary treats selling as advising. This is both unprecedented as a matter of fiduciary law, and not commercially viable.

Secretary Perez has often said that financial advisors should be held to the same best interest standard as doctors, and we fully support that concept. But while the doctor's recommendation of surgery must be made in the patient's best interest, no doctor is required to send the patient to the surgeon down the street simply because the surgeon down the street has more experience or charges less for the same operation. Nor do we require a doctor to lower his or her own fees simply because it would be in the patient's best interest to do so.

So we recommend a conceptually simple and straightforward fix. The rule should separate the terms of engagement of the advisor, that is, the components of the relationship established through the sales process, from the investment recommendation that is made within the terms of that fiduciary relationship. This could be accomplished through a simple, plain English disclosure that would be meaningful to investors and have three key features.

First, it would have a statement describing the scope of an advisor's services, including the transactions on which it is advising, whether the advice is point-in-time or ongoing, and the range of investment options the advisor will consider in making investment recommendations.

Second, it would disclose the compensation payable to the advisor for the types of investment options the advisor might recommend, as well as any other material conflicts of interest.

Third, where needed, it could include a link to a website where an investor may obtain more detailed information about the cost of and compensation to related to any recommended investments. Once that relationship is established, all of the advisor's recommendations within that engagement framework then must be in the best interest of the advisor.

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

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

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

Some commenters, including supporters of the rule, have asked the Department to allow fee-based advisors to engage in selling their own products and services free from fiduciary constraints. And this is actually consistent with our alternative approach. But while these comments would limit the approach to fee-based advisors, there is no logical or principle basis for doing so.

Whether an advisor's compensation is transaction-based or fee-based, the advisor must be free to determine the terms of its engagement and, accompanied by appropriate disclosure, persuade the investor that it should enter into an advice relationship under those terms and conditions. That activity is simply not fiduciary in nature.

Moreover, if the Department adopts a rule that allows fee-based advisors to establish the terms and conditions and their engagement, but does not apply similar concepts to transaction-based advisors, it would clearly be favoring one business model over another, which will ultimately deny investors choice in how they pay for financial services.

I'd like to now turn to the second fundamental problem with the rule that's proposed, which is the prohibited transaction relief. Where an advisor's compensation varies based on the products and services recommended within the engagement framework I've described, a prohibited transaction exemption is still needed.

Unfortunately, the exemption structure in the proposal is so burdened with unnecessary restrictions and conditions that it is anything but principles-based and largely unworkable. The problem is easily solved by implementing what the Department said it was aiming to do: create a broad, principles-based approach that provides an exemption for regulated financial institutions that agree to act in the investor's best interest.

In fact, the Department, within this very same rule proposal, does follow a true principles-based approach in the form of standards of impartial conduct that are proposed as amendments to several existing exemptions. Those standards should form the basis for the broad principles-based exemption the Department has promised, that is, a commitment to act in the customer's best interest, payment of no more than reasonable compensation, and full disclosure of material conflicts. No other limitations or conditions are needed.

Adopting a best interest exemption that mirrors these standards of impartial conduct would eliminate the most burdensome aspects of the BIC exemption with the written contract requirement and the disclosure rules.

The proposal to create legal enforceability through a written contract with signatures in the BIC exemption is simply not workable. For example, it would require contracts between thousands of individual representatives and millions of customers and potential customers, including plan participants who do not today have a contractual relationship at all with the plan's service provider.

Instead of a written contract, the exemption should allow for the creation of a legally binding commitment established on the basis of the unilateral contract with the customer. And that commitment could in fact be made in connection with disclosure, establishing the terms and conditions of the engagement, as I just described.

We also suggest replacing the confusing and extremely burdensome three-part disclosure regime in the proposal with a simplified disclosure consisting of the same terms and conditions of engagement, a general description of the compensation and material conflicts with the advisor, along with a link where appropriate to an investor-focused website including detailed information on all the products and services recommended by the advisor.

We believe that the expansive and indeed overwhelming disclosure regime proposed by the Department will obscure the information that's more important to investors, that is, the scope and nature of the advice they're receiving, and how their advisor is being compensated. And this avalanche of information, which will not be useful to investors, would require enormous costs to produce and disseminate.

We need to make this rule workable so that we can continue to provide investment assistance to millions of working Americans. And a simple example of a transaction we handle perhaps hundreds of times a day at Fidelity might help illustrate the problem.

A newly hired employee, one of our plan sponsored clients -- let's call her Jane -- calls a representative in one of our call centers. Jane tells our representative she'd like to enroll in her company's 401K plan. We ask her how much would you like to contribute. Jane says 6 percent of pay, and we say great. You're going to maximize your company match.

We then ask Jane how she'd like her

contributions invested, and perhaps begin to describe in general terms the funds in her plan's fund lineup. But before we even get through describing those funds, Jane says, I have no idea what funds to choose, and don't really want to manage my own investments.

Today, we would tell Jane she should consider the plan's target-date fund, which would likely be one of Fidelity's Freedom funds. And if Jane agrees that's appropriate for her, she'd complete her enrollment.

Under this rule proposal, before we could even mention that Jane consider a Fidelity fund, we'd have to stop the conversation, send her a detailed written contract for signature, and prepare and deliver a point of sale disclosure document for that recommendation.

From our experience, we know that if we put those types of barriers in place, many people will simply drop out of the enrollment process and never start contributing to the plan. Unless significant changes are made, this rule as proposed will inevitably reduce retirement savings for millions of low and middle income working families.

So I will end where I began. Fidelity supports a best interest standard for investment advice. But we urge the Department to adopt our simpler best interest alternative so that we can continue to meet the needs of America's retirement investors. Thank you.

MR. HAUSER: Thank you.

Ms. Garrett?

MS. GARRETT: I'm very pleased to be here. Thank you for the opportunity. First of all, I'd like to acknowledge the wonderful work that has been done with the Department of Labor and getting this far with the proposal and listening to the feedback and working through this process.

I'm also part of the Committee for the Fiduciary Standard, and individuals representing that organization have spoken and will be speaking and testifying over these days. But I wanted to share some of my own thoughts.

I'm Sheryl Garrett. I represent the Garrett Planning Network. And I'll go into that possibly a little bit more in detail. But I'm speaking on behalf of my own experiences and my own viewpoints.

The current rules that we're dealing with, as everyone knows, were written 40 some years ago, and they have not kept pace with the changing ways that Americans invest and save currently. 401K plans didn't exist back then. IRAs were barely in existence. The transfer of responsibility has shifted to the individual, and therefore making objective advice even more important than ever.

Unless the DOL rule is updated and broadened as proposed, many workers and retirees will continue to be vulnerable to conflicted advice from brokers who are not legally obligated to put their clients' best interest first.

In a survey conducted by the Financial Planning Coalition, the Consumer Federation of America, and the National Association of State Securities Administrators, they show that 97 percent of investors polled indicated that they believed that anyone rendering advice would put it in their best interest.

That's what the individuals expect, but it's not the law of the land. But the American public does not know that. Why should they be responsible for figuring out the different schemes that we have in our regulatory environment. It shouldn't be up to the consumers of financial advice.

Americans are paying a heavy price for this. Not everyone, but as was mentioned earlier today, those most affected by the heavier prices are those with more modest means, the folks that I have primarily spent my career working with and focusing on, paying a heavy price to the tune of tens of thousands of dollars, if not hundreds of thousands of dollars. And I'm speaking of low to middle to upper middle income individuals in lost retirement income. And this is based on the current status quo, which permits trusted advisors to profit at their client's expense.

One point I'd like to mention is that these individuals often don't even know what they're paying, or that they are paying.

Cerulli Associates did a study not too long ago, two or three years, four years ago, and approximately 25 percent or a quarter of the respondents didn't believe they were paying anything. These are individuals who are all working with a financial advisor or broker. They didn't believe they were paying anything for that advice. And as we all know, financial advisors and brokers, registered representatives, need to be compensated for their professional services.

Another 25 percent, approximately, of this cohort didn't know how much they paid. So they don't know the value of what they're paying for. They don't know how to compare that against other service offerings or anything like that. So with that kind of opaqueness in the system, I'm looking forward to having painful transparency.

I've seen the type of issues over and over in the last 28 years that I've been in this business. In the first 18 years, I worked as a personal financial planner, as a registered representative, eventually as an hourly-based -- hourly only, fee only financial advisor.

One point that has been discussed many times, and I've seen it in writing and on various conference calls, the discussion of fee-based or fee-only services or fee services -- and that's automatically equated with assets under management. And I would like to clarify for the record that that is one form of fee compensation. And I also agree with those who have shared that every compensation structure does have conflicts.

But I want to broaden the concept that fee compensation is not just assets under management. That would be an ongoing payment mechanism or a payment scheme. There could be a one-time payment in fees, and it could be an ongoing, monthly type of thing. It could be periodic or an as-needed type of service, which is how I worked with my clients most of the latter years.

Throughout my career, I spent most of my time working with middle income clients and their families. In the last 15 years, I've headed up a network, a nationwide network, of financial advisors who are doing just the same with no minimums. So fiduciary advisors accessible to all people, objective, competent advice as fiduciaries.

Over the last ten years, I've spent time working as a litigation consultant and an expert witness, and I'd love to share any of those detailed stories. I'll just briefly mention those -- a little bit of that in this introduction because that's where I got truly passionate and -- passionate is an understatement -- blood boiling, very enthusiastic to I've got to become involved.

So I witnessed a number of different cases in this litigation work, where dozens of individuals were inappropriately advised. And I use the word advised -- the advisors in question in this series I'm talking about were registered representatives.

But they were advised, provided advice, direction, recommendations, whatever you want to call it, but told what to do. The individuals came to the professional and said, what should I do. They were offered an early retirement buyout from their employer, a company-sponsored defined benefit pension plan and 401K. A few of them had ESOP plans.

And lo and behold, this whole series of cases, which there were a few dozen people involved over the years that I've worked with, all of them were middle income individuals, for the most part making wages of $25- to $45,000 a year, by their late 40s to early 50s had amassed a fairly substantial sum in their retirement nest egg.

But then they were offered an early retirement out package from their employer, which was Pac Bell Telephone Company in this specific example that I'm giving, which sweetened the offer to allow them to take an early retirement out at that young age. Just because they were eligible to retire did not make them able to afford to retire, kind of like you might be eligible to qualify for a mortgage, but that doesn't mean you can afford to pay it. Same thing with being eligible to retire.

So many of these individuals are now in their early 60s, and they're dead broke, very financially devastated. Some said, you know, this advisor ruined my life. I tried to reframe that, your financial life. But it's really heartbreaking about what has happened to too many people. And, of course, this is a rare situation. But these individuals entrusted their entire retirement nest egg to advisors who did not put their best interests first.

One of the reasons this came to my attention, these series of cases, is the concept of financial advisors often do not get paid unless they get the hands on the money. So without a retirement occurring, or a rollover occurring, no money left the retirement plan, the ERISA-qualified plan, unless these people chose to retire. So they were provided with advice encouraging them to take the distribution. And then the money was reinvested, and needed to provide their standard of living for every month. It was put in variable annuities, either exclusively or almost entirely, and with a 7 percent surrender penalty with every single monthly withdrawal, for 2.4 percent minimum mortality and expense fee that we heard on the earlier panel. It was an average.

The advisor also calculated the withdrawal rate that these retirees could take, and the lowest withdrawal rate, excluding fees, was just over 8 percent, done as a 72T, substantially equal distribution, periodic payment distribution.

So I've worked with middle income clients most of my career, and I've only known of a couple of people out of maybe 1,000 clients that could afford to retire, that had enough money to retire. But lo and behold, for some reason, these advisors' clients could all afford to retire in their early 40s and late 50s.

Most advisors do have their clients' best interests in mind. However, they're not legally obligated to put their clients' best interests first. And I feel that if we're going to hold ourselves out as advisors, rendering advice, telling people what to do with their money, and where that -- to make those investments, where is the money coming from?

I've got a stack of details of stories, horror stories, from financial advisors over the last few months that I've collected. I've heard a number of these over the years. As I've shared just nuggets of these cases, and they're just appalled. Regardless of the distribution channel or the service model they work in, these individuals, the financial advisors, are appalled at these kind of actions.

So there are plenty of fiduciary advisors out there, or advisors who are willing -- ready, willing, and able to take on that fiduciary mantle and serve their client's best interest. That's what they're currently doing, and they're willing and able to follow the regulation to do so continually.

So I applaud the DOL for continuing this work, and thank you for allowing me to share my thoughts.

MR. HAUSER: Thank you.

Mr. Nelson?

MR. NELSON: Thank you, Deputy Assistant Secretary Hauser and the other members of the panel for this opportunity to discuss the Department's proposed regulation redefining fiduciary investment advice for ERISA plans and IRAs.

Voya Financial, along with thousands of advisors and TPAs, serves the needs of over 13 million individual and institutional clients, including approximately 46,000 retirement plan sponsors and 5 million plan participants. We take this responsibility very seriously, and we and our partners are committed to acting in the best interests of all of our clients, with a clear, unified mission to make a secure financial future possible one person, one family, one institution at a time.

We share the Department's goal of improving the quality and availability of financial advice to workers, retirees, and their families. We are focused on helping Americans plan, invest, and protect their savings so they can retire with financial security.

That's why I'm here today. Despite the Department's admirable intentions, I'm concerned that the proposal fails to achieve our shared goal because of its unintended consequences, which will actually reduce access to advice due to fewer advisors and providers willing to take on the liability and make it more costly for plan sponsors and individuals to receive the education and advice they need.

This will ultimately jeopardize the availability of advice and education, and will accelerate leakage from retirement plans.

Given our limited time today, I'd like to focus on three key areas in which we think the rule needs to be revised to better serve working Americans. First, let's discuss the best interest contract exemption, or the BIC exemption. If it is finalized, it must be substantially revised to actually serve the best interests of participants and IRA owners. In our comment letter, we recommended solving some of the BIC exemption problems with what we call the customer's bill of rights.

The BIC exemption process is just not practical. It needs to be simplified and streamlined.

As proposed, an advisor would need a signed agreement addressing a significant number of disclosures and representations, obligations even before discussing the recipient's circumstances. Participants will be confused, frustrated, and annoyed when asked to sign an agreement to have a preliminary conversation with an advisor they may not even hire.

I'm sure you will agree; it is not productive regulation to create an environment that may encourage participants to turn away from essential advice at a crucial time because of an unprecedented and cumbersome consumer transaction process. The BIC exemption effectively outsources enforcement of the prohibited transaction rules to the plaintiff's bar, including new potential class action -- class actions under state laws.

We question whether the Department even has the authority to create these alternative remedies to ERISA's exclusive remedies. However, the new and untested legal liabilities resulting from the contract are one of many reasons it is unlikely to be used by advisors in its current form.

If a participant does not sign the BIC agreement, we firmly believe that the extensive new point of sale quarterly and website disclosures will be sufficiently voluminous that many participants will find little or no value in them, despite the significant cost to advisors and providers, which they are going to incur that will ultimately be passed on to the consumer.

That's why we recommended replacing these with a simple, one-page customer's bill of rights. The bill of rights provides a participant or an IRA owner with an easy to understand information needed to make an informed decision.

Under this approach, the participant could acknowledge receipt of a clear document setting out key disclosures, compensation terms, and any potential conflicts before any money is invested or fees are paid. We attached a sample of the customer's bill of rights to our comment letter, and I have a copy for you here today.

As you can see, it clearly states out whether the advisor receives any differential compensation, whether the advisor offers proprietary products, and lists the basic compensation received by the advisor and its affiliates for each investment. The customer's bill of rights also informs customers that they have the right to ask for additional compensation, and advises them to comparison shop with different advisors.

The whole point is to give participants and IRA owners useful and actionable information that ensures their understanding. We also want to encourage participants and IRA owners to compare available services and investment options, which can be more easily done through this simpler, less data-intensive approach.

The BIC exemption disclosures are not a cost-efficient means of providing useful information, and the expense will ultimately be borne by participants and IRA owners. The customer bill of rights by contrast is a very efficient, consumer-friendly way of providing this information.

Another advantage of the customer bill of rights concept is that it identifies whether proprietary products are being made available and under what terms. This is an effective means of upfront disclosure, allowing the Department to modify the BIC exemption, to clarify that advisory grade proprietary products does not violate any impartiality standards.

This change is essential because the proposed language that investment advice must be provided, I quote, "without regard to the financial or other interest of the advisor, financial institution, or any affiliate, related entity, or other party," end quote. That's just too open-ended and prone to confusion. It invites after-the-fact second guessing and creates unwarranted litigation risk for offering proprietary products.

Secondly, we think the large plan exclusion is just too limited, an arbitrary threshold; and its impractical application based on participant head count bears no obvious relationship to financial sophistication. The proposal denies small plans, participants and IRA owners the same investor choices that large plans have when deciding to purchase a product rather than to receive advice.

The Department wrote that, I quote, "The overall purpose of this seller's carveout is to avoid imposing ERISA fiduciary obligations on sales pitches that are part of an arm's length transaction where neither side assumes the counterparty to the plan is acting as an impartial trusted advisor," end quote.

We agree. But this logic also applies to all plans, regardless of size, and to IRAs. Like larger plans, smaller plans and IRAs benefit from more, not less, information. Restricting a seller's carveout will lead to less information being provided to them. The large plan disclosures would serve equally well to protect small plans and IRA owners from misunderstanding the true nature of a sales discussion.

We also believe that our customer's bill of rights could serve in this role, making it clear that sales information is not fiduciary advice. It does not require financial sophistication to distinguish between sales activity and advice activity, where the activity status and compensation are fully disclosed. The Department should adopt a general sales exclusion for all plans and IRAs, as it did in 2010, while adding clear disclosure.

Finally, I'd like to address the proposal's restriction on educational activities. There is no denying that workers face financial decisions that many do not feel well equipped to make, and they must have access to advice and education to help them do so. Reducing that access, as the proposal does, has an even bigger cost to participants and IRA owners than the conflicts the rule is intended to address.

The Department's own 2011 estimate showed the lack -- that lack of access to advice cost participants more than $100 billion every year in preventable investment errors. Interpretative

Bulletin 96-1 provides a proven and effective pathway for participants to receive and act on educational information.

I emphasize acting on education because the industry's long experience with in-person education meetings and online investment and education tools for IRA account holders shows that the biggest challenge is getting people to act on what they have learned. The Department should retain its key elements even as they expand its scope.

Another concern in the proposal would prevent many advisors and providers from encouraging participants to not cash out balances when they change jobs, and instead roll their plan, their prior plan, and IRA balances into the new employer's plan. The broad scope of the proposal would transform this education into fiduciary advice regarding a rollover or a distribution. This likely would result in a greater retirement plan leakage and loss of retirement savings. Any final rule should exclude encouraging consolidation from fiduciary advice so we can continue to better serve participants with actionable educational information.

In conclusion, participants and IRA owners need access to quality advice and investment services to achieve their retirement goals. The way to get there is to make the advice more widely available. The proposal does not do this, and its unintended consequences limit choices, reduce educational opportunities, and pose significant costs on participants.

We want to work with the Department so that any final rule works for participants, and we think these ideas can contribute.

Thank you again for the opportunity to testify, and I look forward to answering any of your questions.

MR. HAUSER: Thank you. Mr. Nelson, maybe just starting with the customer's bill of rights that you proposed.

MR. NELSON: Sure.

MR. HAUSER: I mean, as I read this, I'm -- I guess I'm not seeing the rights part, to be honest with you. I mean, so is there a commitment to give -- make a recommendation that's prudent as part of the bill of rights, and would Voya agree to make prudent recommendations as -- I mean, is that something that you would be comfortable with?

MR. NELSON: Well, thank you for your question. You know, the bill of rights is really an upfront disclosure, and we think it should be connected with the seller's carveout. It should be simple and easy to use. And, you know, by providing the information to a participants on the funds, their cost, someone's compensation, what role they're playing in the transaction, we think goes a long ways towards information participants so they make better long-term decisions.

You know, we're certainly in favor of doing what is in the best interests of clients and customers, I should say, in that regard. And we think a fulsome disclosure such as the customer bill of rights really makes great progress towards that.

MR. HAUSER: So in terms of the fulsome disclosure, at least as outlined in your bill of rights, it says, "We may receive more compensation, depending on the product or investment select. We may recommend proprietary products." There is nothing, in this document at least, that discloses any of the specifics. It's kind of a generic disclosure that the person talking to you may get conflicted payments. Is there more to your proposal than that?

MR. NELSON: There is much more. What you're looking at is a draft essentially. And where you see the words "may or may not" would be more customized to the individual situation.

Oftentimes, though, as you can appreciate, when you're entering into an initial conversation with a potential customer, you don't know where that conversation can go, what they may or may not invest in. And so you have to have the appropriate flexibility in any customer bill of rights to make sure that they understand what are the types of compensation that you would be receiving, what are the available investment options that they could invest in, and what role you are playing.

You know, these are -- you know, I think it was mentioned earlier in a number of the testimony to -- we think the participants can distinguish between a sales presentation and advice. And there are two different approaches.

MR. HAUSER: Why do you think those are two different things really? I mean, I've heard the sale/advice dichotomy being drawn by lots of people. But as a rule, you know, don't -- aren't both things happening? Aren't people looking to your representatives for professional guidance in how to manage their money, even as they also understand that you may be selling them something?

MR. NELSON: Not necessarily. You know, I think, yeah, that's a fascinating question because in every commercial transaction, as it was identified earlier, there is someone who is providing the service or product, and there is someone who is consuming or purchasing that, that product or a service.

You don't necessarily know what types of services or products that someone may ultimately select from, and there could be a wide range. So, you know, in your characterization, I'm not sure that's completely fair to say that all participants want advice, because some may want more advice, some may want just some education and some information.

MR. HAUSER: But before your representatives make a recommendation to somebody on what -- how to invest their retirement assets, do they make any inquiry into their individual circumstances?

MR. NELSON: Sure.

MR. HAUSER: And do they try to ensure that at a minimum that recommendation is suitable for them in light of their particular circumstances?

MR. NELSON: Again, it depends on the types of recommendations that might be coming. If it comes through, for example, an managed account solution, that could be covered under SunAmerica, so it's a different type of a transaction or a service, if you will.

MR. HAUSER: What do your representatives call themselves in their dealings with your customers? Do they call themselves salesmen, or do they use some other nomenclature?

MR. NELSON: Representative of Voya Financial.

MR. HAUSER: That's it? They don't call themselves advisors or consultants or investment professionals? What --

MR. NELSON: We have --

MR. HAUSER: Do you have a preferred corporate term that your people use?

MR. NELSON: We do.

MR. HAUSER: What is that?

MR. NELSON: Huh?

MR. HAUSER: And what is that?

MR. NELSON: Well, you know, we have about 6,000 employees and lots of different titles, okay?

MR. HAUSER: Yeah.

MR. NELSON: So in fairness -- and I'm not going to go through all 6,000 titles for you, save you the torture there. However --

MR. HAUSER: That's too many categories to manage, I would think.

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

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

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

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

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

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

MR. NELSON: Account executives, that type of thing, too.

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

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

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

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

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

MR. HAUSER: Okay. But so for purposes of our regulatory project, you would be opposed -- and, I mean, just please correct me if I'm wrong. I don't want to put words in your mouth. You would be opposed to our imposing an ERISA prudence obligation or an ERISA, you know, loyalty obligation on your representatives, either in their dealings with plans or in their dealings with IRAs. Is that correct?

MR. NELSON: Not completely. You know, I think -- you know, we're probably, you know, slicing -- you know, splitting hairs here a little bit. It's -- you know, being able to work in the best interests of -- for clients in the retirement space does not necessarily require, I don't believe, that we need to do it under the umbrella of ERISA or the prohibited transaction rules.

So we can be in favor of doing what is in the best interest of clients and making sure that they have the appropriate education, they have all the right information to make informed decisions, that we disclose all appropriate compensation, any proprietary investment options that may be there, or other types of services.

You know, I think informing participants of all of that type of information is in the best interest of clients, and we are very much in favor of that.

MR. HAUSER: But at bottom, your proposal is we simply impose as set of disclosure obligations, and that's it.

MR. NELSON: As separate from the prohibited transaction and ERISA.

MR. HAUSER: And those disclosure obligations, in your mind, could they include such things as the precise amount of compensation that the representative is receiving in connection with the recommendation?

MR. NELSON: Yes.

MR. HAUSER: Okay. So, Mr. Derbyshire, a couple of things. And I apologize. You know, at this point, I've read so many comments, I'm afraid I might, I'm afraid --

MR. DERBYSHIRE: You didn't read all 57 pages?

MR. HAUSER: No. I absolutely -- I read every single page and underlined it and circled stuff, and even, you know, put exclamation points next to a couple of things. But I'm getting a little confused in my own mind between what was in some other people's comments letters. So if I get something wrong here, let me know.

But one thing I did think was helpful here was your framework on making the mechanics of executing the contract a little more simple. And the people we talked to yesterday as well, there were a number of suggestions. And I'm sticking right now not with kind of our best interest contract exemption, rather than the new paradigm that you proposed.

But I just want to see if you think these things would be significant improvements, and if you think we should go further in terms of the mechanics of executing the contract. What a number of people suggested were, one, in terms of the timing of the contract, that it would make a lot more sense that as to existing customers, it essentially be done by some species of negative assent. You send out a notice to your customers of one sort or another saying here are the new obligations. I mean, here is what we're undertaking to do for you.

And that would be kind of it for your existing customer base, unless and until they executed a new contract. Does that make sense? Is that at least an improvement?

MR. DERBYSHIRE: For existing customers, I suppose that would be an improvement over a wet signature that has to be returned to you. I still don't think it's necessary to have even a negative consent approach, but --

MR. HAUSER: What kind of -- would that be a big operational issue, though, for Fidelity?

MR. DERBYSHIRE: It would require mailing out notices to, you know, our 23 million customers potentially affected by this, but --

MR. HAUSER: So we can have a conversation about electronic --

MR. DERBYSHIRE: The question is whether it's really necessary.

MR. HAUSER: Okay.

MR. DERBYSHIRE: I'd be more interested to hear what you're going to say about new customers.

MR. HAUSER: Okay. So new customers, what a number of folks have proposed is similarly you would execute the contract, I mean the same time you execute an account opening agreement.

The contract perhaps could -- it would be adequate that it essentially be signed or executed only by the firm, you know, as opposed to try -- and just the firm just speaking on behalf of all its -- you know, the affiliates and call center folks, and that it essentially reached back in time. If the person has decided that they're now going to entrust the money to -- I mean invest the money with you, that it would reach back and cover the recommendations that had been made.

But there wouldn't be a necessity for the contract before that moment.

MR. DERBYSHIRE: I don't think that works at all, and I'll give you a very simple reason why not.

MR. HAUSER: Okay.

MR. DERBYSHIRE: We could have a person walk into one of our branches, sit down with our account executive, and have a full conversation, and we recommend to them a Fidelity fund. They could stand up from there and walk next door to Schwab and purchase that fund in their platform. And that's a prohibited transaction under your rule because we have recommended a Fidelity fund, and they have purchased a Fidelity fund. But we have no way of enforcing that the contract be signed, no way of knowing whether they even purchased that particular investment.

So, you know, the way the rule is constructed, it kind of assumes that people are sitting down with an advisor. The advisor recommends something, and then they execute on it. But that's not the way the vast majority of our guidance interactions go forward. We give people recommendations. They listen to them. They consider them. They go home. They talk with their spouse. They talk to their brother-in-law, their neighbor. And then they do some of it, all of it, part of it.

Who knows who they do it with? We don't know either.

So it's really not workable. The only way we could comply with that written contract requirement is that we get signature at the point before we make the recommendation, which would essentially require that the minute someone walks into some of our -- one of our branches, we give them a contract and say, before we talk to you, we'd like you to sign this contract.

So that's in the retail side. On the 401K side, we do not have contracts with the participants in our 401K plans. In fact, if I presented a contract to a 401K participant, they'd probably be looking at me like, what is this. I don't have a relationship with Fidelity. You service my account, right? For many of our participants, we are just a service provider to that plan. We do the recordkeeping, et cetera. And so they have no expectation or interest in signing a contract with us. And I think they'd find that an extremely foreign concept.

Again, the mechanics of putting that in place would be daunting as well.

MR. HAUSER: And you could -- and presumably -- and again, I assume you'd have similar objections. But if a contract were executed with, you know, a fiduciary for the plan as part of an advice arrangement and essentially just made the participants third-party beneficiaries, that would be a problem?

MR. DERBYSHIRE: So that would obviously be much more workable because we obviously have contracts with all of our plan sponsor clients for the services that we provide. Again, there is the kind of retroactive repapering of the 24,000-odd relationships we have. But certainly that would be much more workable on the plan side.

MR. HAUSER: And then maybe -- now moving on to your --

MR. DERBYSHIRE: But could I just introduce something, though? There is one --

MR. HAUSER: yes.

MR. DERBYSHIRE: -- interesting aspect of this entire rule that I'm not sure anyone has really examined, including plan sponsors, which is what is the plan sponsor's willingness for their service provider to take on a fiduciary role in providing the kind of help that we -- that our plan sponsors expect us to provide to participants?

I gave the example before of a typical enrollment transactions, where we're just trying to help someone make a decision, which invariably will result in us tending to suggest a course of conduct that would be investment advice under this rule. If that's made fiduciary in nature --

MR. HAUSER: Well, I don't the test is tending to suggest. I think now you're taking language that maybe bothers you, and you're adding an additional level of indirect --

MR. DERBYSHIRE: So, I --

MR. HAUSER: -- I mean, we've made it pretty clear at this point that we're talking about recommendations in the FINRA sense of recommendation, and that suggestion language is in the FINRA guidance. So it's pretty much the same concept.

So does that -- I mean, if we draw the line at what a recommendation is essentially at the same place FINRA does, does it really raise all these issues?

MR. DERBYSHIRE: Yes, I think it does

because the transaction I just identified for you would be a recommendation under FINRA guidelines --

MR. HAUSER: Okay.

MR. DERBYSHIRE: -- because it would be identifying a specific investment fund for a specific person in a context where you would expect them to act on that suggestion. So at least at Fidelity, we would view that as a recommendation subject to FINRA suitability requirements.

MR. HAUSER: Right.

MR. DERBYSHIRE: So --

MR. HAUSER: And assuming there is a fee in connection with that -- I mean, I think it is our aim that that be subject to a best interest standard, I mean, just so --

MR. DERBYSHIRE: Understood.

MR. HAUSER: Yeah.

MR. DERBYSHIRE: And we're prepared to do that. It's just the contract that has to be in place before we make that recommendation that was discussed is problematic.

MR. HAUSER: So moving on to your proposal about what the -- you know, this, the new paradigm contract, I mean, I could benefit, I think, from a little more detail of what you view the timing of that contract as being.

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

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

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

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

MR. DERBYSHIRE: Yeah.

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

MR. DERBYSHIRE: Okay. So you're moving off to the --

MR. HAUSER: Yeah, yeah. No, I'm sorry. If I wasn't clear about that --

MR. DERBYSHIRE: That's fine. We've been talking about the exemption for a while. So that would have to be provided at the point of engagement with the client.

MR. HAUSER: So the point of engagement meaning when they've decided to spend the money?

MR. DERBYSHIRE: No. The point that they start discussions with us.

MR. HAUSER: So you'd be prepared to have a contract -- I mean to present them with a contract essentially before you've even begun discussions?

MR. DERBYSHIRE: It wouldn't be a contract. It would be a statement as to what is the scope of our advisory services and how we would get paid for those. I think at that point, it would also make sense to include the best interest contract commitment at that point, but it would be an ongoing statement to the customer about the nature of the services that we're providing.

And those types of documents are actually available to most customers on our website today, right? So there are -- you know, for investment advisory services, there are ADV statements. There are many disclosures of rep compensation and other things that you can find in our website. I think what we're talking about here is being a little more prescriptive about it and upfront, and making sure that someone has assented to those terms before the discussion takes place.

MR. HAUSER: And then how would you -- and so how does the best interest -- I mean, I suppose -- so let me, going back -- I hate switching back and forth between your exemption --

MR. DERBYSHIRE: Yeah.

MR. HAUSER: -- and mine, I guess. But under the best interest contract exemption -- so would a document like that work in your mind for the mechanics of executing a best interest contract exemption were we to move forward with our current proposal?

MR. DERBYSHIRE: Again, I'm not --

MR. HAUSER: You give them something at the start that lays out essentially the best interest obligations the way we said it?

MR. DERBYSHIRE: I think so. I mean, you use the word execution. That kind of --

MR. HAUSER: No. I'm sorry.

MR. DERBYSHIRE: -- we're back in that because to me that means signing something, and that's the real problem, is getting someone to sign something. So I was going to say we make commitments to our customers all the time. We have a customer protection guarantee that protects customers against data breaches or fraud in their account. And so nobody signs that, but we certainly are accountable to that, and I'm quite sure a court would enforce it against us if it ever came to that.

So I think those kinds of commitments are legally enforceable, and should be sufficient in the context of this rulemaking.

MR. HAUSER: Okay. I understand. And so -- and then once you've agreed on whatever -- I mean, I assume -- so as I understood your proposal, you can kind of define the limited array of products that you're willing to talk to the customer about, what the compensation generally speaking is. Now, are we going to be using that -- or compensation may be affected, you know, by what we recommend stuff? or is this really the customer being told exactly what each things is going to cost?

MR. DERBYSHIRE: So I think this actually gets into a lot of what this morning's panels discussed about the balance of information and how much is too much. You know, a regular retail customer coming to Fidelity has a choice of, you know, many thousands of mutual funds, individual stocks and bonds, CDs, you name it, many choices of investments. To incorporate that in any single disclosure would be virtually impossible.

But having a range of compensation available that is payable with respect to different options, that could be workable. I think that's something that we need to explore. But the idea is that, yes, I think you should be able to say that my compensation will vary based on the investments that you choose, and here is the range, and here is where you can get precise information about each of those.

MR. HAUSER: And then how does the best interest commitment work within that framework? I mean, could, for example, if -- say there was a rollover from somebody, and the way you've -- from some plan. The way you've defined the scope of the agreement, it's only going to cover a certain range of funds, all of which on some level are -- they're essentially equivalents of what the person has on the plan, except they cost more.

Are you good to go, or would that be a

prudence or a best interest violation under your agreement?

MR. DERBYSHIRE: Well, I think you're talking about a couple of things. One would be the recommendation of a distribution from that plan that would then go to these higher fee investments. So the question -- the first question is, is the advisor advising on the distribution. Under the proposal that we're making here, if the advisor wants to do that, they have to undertake a best interest obligation with respect to that advice, and therefore would have to consider the relative cost of the funds in the plan versus whatever else they might be recommending on their platform.

The alternative would be that the advisor does not have to advise on the distribution, but they'd have to be very clear about that because if they weren't, they would know that their distribution, quote, "discussion," whatever it entailed, runs the risks of being investment advice.

So people would have to be very clear that, "I'm not advising you about whether it makes sense to take a distribution from your plan or not. But if you would like to rollover to an IRA, here are the products and services that I offer on my IRA. And if you choose to do that, then I will advise you on those products and services."

MR. HAUSER: And within those products and services, would it be a violation of the best interest commitment for the -- whoever it is, your rep, to steer somebody to one product versus the other based on its earning or compensation for that rep?

MR. DERBYSHIRE: At that point, the best interest obligation would kick in. I wouldn't say it would be a violation of the PT rules because the exemption would cover it, but that recommendation would have to be made in their best interests under the definition the Department has proposed.

MR. HAUSER: And would you be prohibited from incentivizing your people to recommend products in a way that runs counter to their best interest standard?

MR. DERBYSHIRE: I think the way that would be handled is the financial institution is under a best interest obligation itself, and therefore it would be incumbent on the institution to ensure that its representatives adhere to that standard. If they set up a compensation mechanism that resulted in people violating that standard, then the financial institution would be at risk for violating the best interest standard.

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

So that's how I would manage that.

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

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

MS. GARRETT: As far as an adverse effect on individuals with more modest account sizes -- I still have a difficulty calling them small savers or small investors or large investors or so forth, so I'm trying to correct my own language. But those with more modest account sizes, currently our organization of about 300 advisors across the country, we have no minimums. So we're serving them currently, and have been for the last 15 years.

Another network was mentioned earlier today, the CFP Board representative from the CFP Board and the Financial Planning Coalition, made up of Financial Planning Association, the CFP Board, and NAPFA, totals something in the neighborhood of about close to 100,000 advisors. And many of these individuals also work with middle income and more lower income to higher income in the middle, the middle market, the mass market.

So there are a number of financial advisors in all kinds of different distribution channels. I think the only ones that are going to have the biggest challenges are those in a proprietary shop, where they have very limited offerings. But those that have the flexibility to provide what they deem the most appropriate for their client will not have any difficulty serving the middle income or lower middle income client at all.

And what we're seeing through the last 15, 20 years is all financial advisors for the most part are adding fee compensation to their revenue mix. They may be getting some commission, but they're also getting fees.

And so if we broaden the definition of fees and not just look at it as assets under management, this 1 percent or whatever, 1.1 percent I heard quoted earlier today as an ongoing annual fee, and start looking at it as a periodic or one-time fee, or an episodic fee, where someone may come in and say -- I'll borrow your example. Was it Jane?

MR. DERBYSHIRE: Jane, yes.

MS. GARRETT: Jane calls up and says, Sheryl, here is my situation. What should I do. And I would talk to her a little bit about -- get more detail, may need to pull out the BIC exemption contract, provide her with what I could -- you know, let her know what I can do for her, pull out the contract if necessary, and have her sign that, and we get busy working in her best interest, and I can provide her with those recommendations. And I actually would be using these two companies, so -- as some of the outlets.

So what we're seeing in the marketplace is not only over the last 40 years we've had great changes with what is going on with retirement plans and the individuals' responsibilities of managing their own financial affairs, but the financial advice industry has definitely changed over these last 40 years.

We didn't have companies represented such as this 40 years ago. So we have a lot of discount brokers. We have a lot of different venues where many financial advisors can go to all these different places and pick and choose which products and services may be most appropriate. And one of the other things that I am so delighted with regarding the proposal is that it covers the distribution of funds.

Some of the horror story letters that I have received from financial advisors talk about people mortgaging their houses to make an investment, to take some secure assets -- you know, someone walks into the bank to buy CDs, and they get a fixed annuity. Not that that's necessarily an inappropriate transaction, but if the individual thought it was FDIC insured and liquid, there would be a problem. So we need a lot more clarity.

Now, with all due respect to my panelists, I disagree that most individuals now -- I think with both companies, they have likely a lot more do-it-yourself type investors that come to them. But I think the general public, they don't have any idea the difference between someone saying this is the array of funds, or this is the array of investments that I can offer to you, versus these are my specific recommendations.

They're not looking for those semantics to try to define what is advice. When someone who holds themselves out as a professional financial advisor, investment advisor, whatever they call themself, registered representative -- I actually had a claimant say she's registered, and she's a representative of the company. That sounded really great. You know, and so the titles don't tell people a whole lot. It's our actions.

So when we're giving advice or we're giving a recommendation, or whatever we want to call it, but if it can be construed as we suggest or, you know, "if you were to roll your money over, here is your 401K or your -- excuse me, your IRA options that I could offer you," that's going to be deemed as advice by the majority of people, in my opinion.

MR. HAUSER: Thank you very much. And I thank all of you on the panel for your help.

Next up.

(Pause.)

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

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

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

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

At this point in the debate, it is settled that gaps in the DOL's 40-year old rule have created a flawed system, one that allows advisors to put their own interests ahead of their clients'. While not all advisors take advantage of this system, far too many do.

It is also settled that workers and retirees in this country are suffering terrible losses as a result. By conservative estimates, the damages add up to tens of billions of dollars per year. The focus now is on industry arguments designed to defeat or weaken the rule, and to preserve the status quo.

At this hearing, I'd like to address several misconceptions that industry opponents have disseminated about the rule, and then I'll close by highlighting one of the single most important ways that DOL can strengthen its proposal.

First of all, opponents of the rule have fostered the misconception that the DOL's proposal is a radical new approach that deviates from the law. In reality, however, the DOL's proposal is a measured and reasonable effort to close loopholes that never had any statutory basis, and to bring its rule into better alignment with what Congress actually said and always intended in ERISA.

ERISA's definition is clear and simple. It provides that a person becomes a fiduciary by rendering investment advice for compensation with respect to retirement plan assets.

Yet in 1975, the DOL issued a rule that deviated substantially from this definition and added elements that had no statutory basis. For example, advice is subject to the fiduciary duty only if it is given regularly, and only if it serves as the, quote, "primary basis," for an investor's decisions. These elements have undermined the DOL's ability to protect retirement savers from conflicts of interest, as Congress intended.

The DOL's new proposal eliminates these loopholes. In addition, it expressly covers recommendations to take a distribution of plan assets. That's a critical juncture in the life of most retirement savers, when the protections of the best interest standard are more important than ever.

With these basic modifications, the DOL has vastly improved upon its current rule, not by stretching the boundaries of ERISA, but by more faithfully implementing its letter and spirit.

Second, industry opponents have complained that the rule prohibits established compensation models unless advisors comply with an allegedly burdensome and complex exemption. In fact, however, advisors have no entitlement to preserve their conflicted compensation models under the law, and the DOL's exemption is appropriately conditioned on reasonable and necessary safeguards.

There is no question that commissioned-based compensation creates impermissible conflicts of interest under ERISA. The DOL's decision to offer an exemption allowing those models to persist is an accommodation, not an entitlement. And while the best interest contract exemption does impose a variety of conditions on the privilege of receiving commissions, that is what the law requires. Under ERISA, the DOL may not create prohibited transactions exemptions unless they adequately protect the interests of plans and plan participants.

In short, advisors who currently receive commissions have three choices: They can comply with the reasonable conditions of the best interest contract exemption; they can arrange their fee structures to eliminate such conflicts of interest; or they can stop providing investment -- retirement investment advice. Under any and all of these scenarios, investors and plan sponsors will be far better off, free from the conflicted advice that has victimized them for decades.

And we will see no advice gap whatsoever.

Contrary to their alarmist predictions, brokers and insurance agents are almost certain to adjust to the new rule rather than withdraw their services. That has been the pattern with every major financial reform in the last century, literally since the early 20th century: dire warnings about upheaval in the financial sector followed by adaptation and ever-growing profits on Wall Street.

More importantly, if those advisors really do abandon their clients, an established and growing population of fiduciary advisors stands ready, willing, and able to serve all retirement savers, regardless of account size, and they will do so under very affordable fee structures.

Third, industry opponents have argued that we should rely on the SEC to address the gaps in the standard of loyalty applicable to advisors. This argument has no basis, and it has been advanced solely to defeat or delay the DOL's rule. The SEC has no legal authority to issue or update any rules implementing ERISA. Congress gave that responsibility clearly to the DOL, recognizing the unique importance of tax-advantaged retirement assets, and the need to protect them under a separate regime, applying the highest possible standards of loyalty and care.

Furthermore, the SEC lacks any authority to regulate advice about investments that are not securities. Yet, retirement accounts routinely include a variety of non-securities investments, including insurance products and even commodities. Unlike the SEC, the DOL has broad authority over these assets as well as any, quote, "moneys or other property," close quote, of a plan.

Nothing in section 913 of the Dodd-Frank Act changes this assessment. Section 913 contains no suggestion that Congress intended the SEC's authority to take precedence over DOL's regulation of retirement investment advice. On the contrary, in section 913, Congress could have taken the opportunity to subordinate the DOL's authority, or to link it in some way with the SEC's oversight, but it chose not to do so.

As a practical matter, forcing DOL to wait for the SEC means indefinite delay, years at a minimum. The SEC is just beginning to decide whether it should embark on a rulemaking to enhance advisor standards under the securities laws. The agency is still mired in indecision, even though five years ago Congress expressly authorized it to act, and the SEC's own staff strongly recommended that it move forward with a rule. Workers and retirees cannot afford to wait any longer, as their retirement savings are being depleted by conflicts of interest every day.

Finally, the DOL can make the rule even stronger by prohibiting the use of mandatory arbitration clauses. Without meaningful private remedies, even the most powerful set of conduct standards cannot adequately protect investors. However, under the proposed best interest contract exemption, advisors can insist that clients enter pre-dispute binding arbitration agreements, thus limiting an investor's right to seek remedies in court. This provision should be eliminated for two reasons.

First, it's not what Congress intended. In the ERISA declaration of policy, Congress expressly stated that its goal was not only to establish standards of conduct, but also to provide, quote, "ready access to the federal courts," closed quote, so that plan participants could seek appropriate remedies. In accordance with that policy, the statute gives plan participants the right to file actions in federal court for violations of the fiduciary duty.

Second, allowing advisors to insist on arbitration leaves investors with a terribly inadequate substitute for judicial remedies. As the

DOL has noted, many arbitrations under the best interest contract exemption would be subject to FINRA's arbitration process. Unfortunately, that system is a grossly deficient dispute resolution mechanism. Consider just the most obvious defects.

First, it is not a fair process, as even so-called public arbitrators are allowed to have had extensive careers in the financial industry. Second, it severely limits discovery, to the detriment of investors. It does not require panels to actually apply the law or to explain their awards. It produces awards that typically fall well short of actual damages, and the attorney's fees that are necessary to bring a claim. And finally, it provides extremely limited avenues for appeal, even when significant unfairness or injustice has occurred.

By favoring arbitration and raising the specter of burdensome litigation in the courts, opponents of the proposed rule are in effect saying that they do not want to be held accountable. That's no justification for weakening the rule.

In closing, I'll reiterate our view that the DOL rule is an extremely important reform that will benefit millions of Americans saving for retirement, and we hope it is finalized as soon as possible.

Thanks very much.

MR. HAUSER: Thank you.

Mr. Campbell?

MR. CAMPBELL: Thank you, Deputy Assistant Secretary Hauser and the other members of the panel for this opportunity to discuss the proposal. I'm here today representing the U.S. Chamber of Commerce, which is the world's largest business organization, representing the interests of more than 3 million businesses of all sizes, sectors, and regions, although most of our members are small businesses.

Our members strive to provide quality retirement benefits, and they take their responsibilities as plan sponsors and fiduciaries very seriously. Our members are the people the Department intends to help with this rule. They're the recipients of advice, and we think that you should listen closely to our concerns.

Our members, especially small businesses, have been very clear. As proposed, we don't think this rule would help us. It would hurt us.

Now, of course, our members want financial advisors to act in their best interests. They're fiduciaries themselves. However, our members believe that this overly broad, overly complicated, overly restrictive, and fundamentally flawed proposal will result in less advice, fewer choices, and more cost. They believe the rule as proposed will restrict their choices of advisors and service models, again especially for small businesses.

Now, with that said, it's time nonetheless to fix the rule. And so we're here to offer our comments and testimony and thoughts to do exactly that.

You know, unfortunately, the proposal's regulatory burden and the choice limitations it imposes fall hardest on those very small businesses that already have the most difficult time offering plans. Working with an advisor makes a small business with less than ten employees twice as likely to offer a plan at all. And for small business with less than 50 employees, they're more than 50 percent more likely to offer a plan when working with an advisor.

Now, our members are concerned, and believe that this proposal, with its massive new compliance and legal liability cost for advisors, will make it infeasible for a portion of those advisors to continue to serve the small plan marketplace, negatively affecting plan formation due to a lack of advice.

Now, some platform providers may step in to offer some turnkey plans designed for unadvised businesses, if the final rule permits that, which is a separate discussion. But this can't fully replace the value of an advisor, especially for small businesses offering IRA-based retirement plans like SEP and Simple IRAs.

Now, we also know that there is a large cost to participants who do not have access to advice. And in 2011, the Department found that partly due to the restrictions of the prohibited transaction rules, the same rules that this proposal would expand more broadly, lack of access to advice and the resulting preventable investment mistakes cost retirement savers $114 billion in 2010 alone, and you estimated that that cost will be more then 100 billion annually going forward. Well, note that this cost is several times greater than the estimated cost of conflicted advice that's the subject of this proposal.

Now, I don't have time today to cover all of the issues we raised in our very extensive comment letter, but we do want to hit a few of those that we think are particularly significant. First and foremost, we object to the discriminatory effect that this proposal would have on our small business members. It permits large plans, those with more than

100 participants, to retain the choice of advisors and service models that are best suited for their needs, but it denies that choice to small businesses and individuals.

Small plans have the same legal obligations as large plans, and they deserve access to the same choice of advisors as large plans. It's interesting that the Department has consistently stated that these kinds of determinations are based on the individual facts and circumstances of a plan. But here the Department is choosing to substitute its one-size-fits-all universal judgment for that of all the small plans and individuals as to what is in their best interest.

The denial of choice is unfortunately a consistent theme in the proposal. For example, the likely effect is to substitute fee-based accounts for transaction-based accounts, despite potentially higher cost for consumers who would prefer one over the other.

For example, the BIC exemption prevents advisors from discussing certain types of assets, even if they're in the recipient's best interest. Our members understand the difference between sales and advice, and they want the choice of both for their plans and IRAs. So any final rule should adopt the Department's approach from 2010 and carve out sales discussions for all plans and IRAs, not just large plans.

Second, our members are concerned about the loss of a vital educational tool in Interpretative Bulletin 96-1. Redefining asset allocation models referencing the plan's investment options as fiduciary advice would significantly disrupt plan sponsor educational efforts. Removing a proven tool without evidence of abuse is a mistake. Forcing participants to connect the dots themselves between asset classes and available investments undermines the purpose of providing the education.

Third, we believe the proposal's definition of advice will confuse participants about when they're receiving fiduciary advice. The proposal requires -- removes the requirement that there be a mutual understanding, and the retention of this concept is critical. Fiduciary status determines the respective expectations and obligations of the recipient and the advisor, and there has to be a mutual intent to protect those expectations.

In addition, the proposal creates a new and undefined term, which is advice specifically directed to the participant, the recipient. It's not clear from the proposal what it means. It's not defined and not really explained. And this isn't a minor ambiguity. This is a major source of potential confusion at the intersection between the marketing of products and the provision of fiduciary advice.

So we ask that the Department retain the requirement of a mutual understanding, and eliminate the "specifically directed to" language in any final regulation to prevent confusion and unnecessary litigation.

Fourth, we think the proposal will negatively effect the requests for proposals that our members use to select and monitor platform providers. The platform provider carveout reads that information must be provided, quote, "without regard to the individualized needs of the plan."

This simply does not work in practice. The platform provider must discuss with the plan how its services would meet the individualized needs that are outlined in the request for proposal.

And if plan fiduciaries are unable to have meaningful discussions with the platform providers about individualized services and investments available due to platform provider concerns about becoming a fiduciary, then our members won't receive the information they need to properly select and monitor. And we believe the Department should remove this language from the platform provider carveout.

Now, fifth, we object to the BIC exemption's limitation on the assets that advisors may discuss. This approved list of assets provides no additional protection from conflicts. Those are already addressed elsewhere in the BIC exemption.

It also presents a whole list of practical problems because it depends on the asset, not the account. An IRA might hold both listed and unlisted assets in the same account, making it difficult to understand how this new standard would apply to the advisor, and this is especially true in a transition rule, when the new rules goes into effect.

Further, the list prevents an advisor from discussing an unlisted asset, no matter how much doing so is actually in the best interests of the IRA owner. And again, we're dealing with tens of millions of IRA owners with an array of different interests. And it's hard to imagine how a single standard is going to cover that.

Again, we don't believe the Department should be substituting its own judgment on a one-size-fits-all basis for the professional and impartial judgment of advisors who are complying with BICE. The list should be removed. But alternatively, if you're unwilling to do that, there are certain common investments, like discretionary account management and non-publicly traded REITs that should be added.

Sixth, the new state court causes of action established by the BIC exemption are a major flaw in the proposal. To begin with, we don't believe the Department actually has the authority to create in an exemption alternative remedies to ERISA's exclusive remedies for participants.

Further, the ambiguity of the subjective conditions that are in the exemption will result in class action lawsuits in state courts, despite good faith efforts to comply. This large legal liability risk will likely prevent many advisors from using BICE as proposed, and therefore rollover and other advice services available to participants and IRA owners will be reduced, which is against their best interest.

We also in general have concerns about both BICE and the general applicability in the rollover area. The Department needs to clearly state under what terms, under what conditions, a rollover would result in a -- a rollover advice would result in a prohibited transaction for which an exemption, BICE or otherwise, is necessary.

Seventh, the disclosure requirements in BICE will be nearly impossible to achieve in just eight months, and extremely costly to the recipients who will ultimately pay. Also, as FINRA pointed out in its comment letter, the disclosures conflict with securities laws and regulations regarding predictions of future performance for some advisors. Any final rule, we believe, should use general rather than individualized disclosures, such as illustrations of the effects of fees over time.

We also note that in implementing EFAST-2, the electronic filing system, the Department itself took about three years, and it's unreasonable to expect the private sector to do an even more difficult system design in just eight months.

Last issue to discuss -- I thank you for the indulgence on the time -- is that we're concerned that the division of guaranteed income products between BICE and 84-24 is going to be confusing to participants and undermine efforts to provide retirement income. Instead of receiving apples to apples information to compare guaranteed income products, an IRA owner evaluating, for example, a variable annuity and an equity index annuity will get different disclosures that aren't readily comparable for what appear to the individual to be similar products in essentially the same category.

We think this is confusing, and we believe that all annuity products should be provided under 84-24 rather than BICE.

Lastly, we would say given these issues --

MR. HAUSER: We can stipulate that that's just a partial list for that.

MR. CAMPBELL: Indeed. There is a lot to cover in this regulation. Lastly, we would say because there is a lot to cover, because of all these issues, and the fact that there -- you know, as these days of hearings have shown -- we believe that really the Department needs to go forward with providing all interested parties a formal second look at your conclusions to these questions so that we can ensure that there is appropriate discussion and opportunity for the public to comment.

MR. HAUSER: Thank you.

MR. CAMPBELL: Thank you.

MR. HAUSER: Mr. Collins?

MR. COLLINS: My name is Joe Collins.

MR. HAUSER: Would you mind pulling the mic there? Thank you.

MR. COLLINS: Oh, use the microphone. Okay. I'm a certified fraud examiner. I became a fraud examiner after the stock market disaster of 2008 that kind of comes -- still going on today. I call it a disaster because it was a disaster for me and a lot of people.

So what is a certified fraud examiner? I have specialized experience and training in the prevention, detection, and investigation of fraud. Donald Cressey years ago created what is called the Fraud Triangle. The Fraud Triangle basically -- you start at the top. You have an unspoken need that you need to fill, like you got a girlfriend on the side or a drug habit or debts or a quota; an opportunity to commit a crime, meaning an opportunity to take something from somebody else; and the ability to suitably justify that crime.

Dr. Joseph Wells, who is a certified fraud examiner and CPA, said 25 years ago that deterrence of fraud yields greater results than prosecuting fraud after the fact. So you need to know what fraud is. I was a financial advisor series seven licensed broker, licensed by FINRA, from 1998 to 2009, for a very large financial planning company. I suspected and reported fraud in my company, and they ended my career.

So my key message points are going to be this. If your moral compass is broken, everything you do is going to look suitable to you. The goals and training I received were in some cases designed to benefit me in the company at the expense of the client. This was indicative of what I call a deviant corporate culture.

We need to change the culture. We need to change the incentives. We need to work on prevention and deterrence rather than trying to prosecute them after they've already ripped off the client, okay?

So I haven't done this before, so there is a quote. And, Tim, if you would help me by completing the quote, if you know it. "In the land of the blind, a one-eyed man is --"

MR. HAUSER: Go ahead.

MR. COLLINS: "-- king." In the land of the blind, a one-eyed man is king. And what we have in America is a lot of people who are completely blind, who know nothing about how financial services works, other than a checking account and a savings account and buying a car.

I support the fiduciary standard of care. Giving conflicted advice should be made fraudulent.

It is fraudulent. We should remove the incentives to commit fraud. I mean, our clients are conflicted enough. I mean, they're trying to decide are they going to buy the Ford F150, or are they going to buy the Tahoe, say? I mean, they have all this conflict going on anyway. Why do we need to add do it?

Early in my career, I had this -- I'm still trying to figure out what it was. It was a thought, a vision, that I might have to stand in front of a judge some day and give an account of every decision I made, every recommendation that I made to my clients. Yet here we are. I made a decision early on in my career to follow a couple of principles. Life is short. Do the right thing, always.

I'm 55 years old. I've got, what, 20, 30 years more to go? That will go by fast. Give clients the unvarnished truth, whether they like it or not. It's not all smiley-faced and happy letters, telling them how great they're doing. There are problems you need to deal with, like getting a will so that what you have goes to your family and not somebody else. And then take care of widows and orphans in their distress. And keep yourself from being polluted by the world.

The system as I see it is -- I guess one way you could call it is biased. The other way you can call it is rigged. That was at my company.

I brought this to the attention of my compliance officers. Clients were put in wrap accounts and left there for years without any contact, and they paid -- every month, they paid a fee. IRA rollovers into annuities -- sorry, I don't agree with the non-publicly traded REITs because they pay 7 percent, and you put the money on Weingarten -- well, once a month, and they still have their money.

What I was taught early on was WDYWFY. Do you all know what that is? WDYWFY, "What Do You Want For Yourself?" This was developed by my CEO and executive vice president, who is still on consult to the company. The WDYWFY model goes like this, okay?

First you have a goal. Goals are great. You record your business, your personals, your self-development goals. You know, it's kind of faster horses, younger women, older whiskey, more money.

Have a plan. Determine your personal and self-development goals. You know, I plan to have 600 clients, make a million dollars a year, $100 a day, 20 appointments a week, 2,000 fees, 5,000 commissions. That's my goal. That's what I'm working towards.

Implement your plan, okay? So I got to

sell, let's see, seven annuities. I've got to sell three theme roles (phonetic) this week. I've got to sell some DI, some long-term care, and put $100,000 in front-load funds because that's where I make the most.

So you control the direction. You learn to keep score. You redirect, engage the help of enablers, okay? Sales managers who can help you achieve your goals, and you throw off discouragement. You learn how to channel your emotions in challenging circumstances. I mean, when Grandma doesn't put her $400,000 into a variable annuity, that can kind of get emotional because you didn't make your car payment.

Having a plan is great. But when the plan conflicts with what your clients need to achieve, I have a problem with that. Take, for instance, a client came to me, and they had -- the couple had $80,000 in credit card debt. I refused to take their money. I refused to take their rollovers, said leave them where they are. They were there. They were fine. They're in good stuff. Until they paid off their debts and build a cash reserve.

It took three years. What did I get paid? Nothing. Was it the right thing for the client? Yes. Was it the right thing for the company? Not so much. They were never -- a client who had paid wrap fees for seven years, they put in 52,000. They went to 26,000. They had an average of $34 to $55 taken out of their account every month. And the branch manager who was supposed to be managing that account spent 99 percent of her time recruiting, and no telling how many more accounts she had.

I mean, it was -- I mean, think about if you've got a few million dollars paying you 1 percent, and that check just comes in every month. I mean, it's more like what they call a multilevel, mailbox money.

I had another client, a very good client. We became good friends. He took me out to a property after we had worked together like six or seven years. He had brought me $580,000. We turned it into 1.2 million, and he had retired. And he wanted to buy this place. Smart guy, one of the two geniuses I've ever known.

And so we went out, and we walked the property. We got soaking wet, 40 acres, built a house, put in roads, put in bridges, and all this stuff. And we get back, and what do you think? And I said, do you really want to go through this. And he just looked at me really mad, and he told several months later he wanted to deck me right there. But he said it was the best advice anybody had ever given him.

What did I get paid? Zero. What did the company get? Zero. But it was the best thing for the client.

The author of the WDYWFY wrote in one of his books, getting what we want is good. Our goals can be at the same time selfish and morally aligned. Let me say that again. 'Getting what one wants for oneself is a rightfully selfish process, provided that what one wants is in alignment with our moral compass.'

MR. HAUSER: So, Mr. Collins, you have about one more minute.

MR. COLLINS: Okay.

MR. HAUSER: And I know that you -- your letter indicated you both had concerns about the alignment of incentives at the company, but you also had a concern that our exemption -- our rule really wasn't going to do much. And I find these criticisms to be therapeutic.

MR. COLLINS: Okay.

MR. HAUSER: So I do want to give you a chance to tell us.

MR. COLLINS: All right. If you get a chance, send somebody down to Austin in the next couple of weeks. There is a mutual fund company that is opening an office there. And they're flying in brokers from -- and I won't mention names. They're putting them up in $700 a night hotel rooms, $600 bottles of sake, and there was one $30,000 dinner for 40 people.

And when you hear them talking, and they're going, yeah, I'll sell that, yeah, I'll sell that, yeah, I'll sell that. We'll buy something else on Monday. And they're out there getting wined and dined. And, yeah, I don't think that's taking care of clients. I think that's what is called payola. We had that in the radio business. We don't need 12B-1 fees. We don't need backdoor payments, okay?

We don't -- I wanted to be able to look my client in the eye and say the only money that I will receive is the money that you pay me for the advice that I give you, or the things that you may implement, okay, that you bought from me.

I tried to turn off the 12B-1 fees. My company said no.

MR. HAUSER: So could you bring it to a close?

MR. COLLINS: Okay. A couple of things that can be done immediately. We found in fraud examination that if you have an employee sign an honesty statement when they start, it will reduce fraud -- I think is was somewhere between 10 and 30 percent. That's something that can be done immediately. You just sign a statement that says, I promise to do the best thing for my client always. It's real simple.

Statement review meetings can be implemented immediately. That's where you take that 19 pages -- and they only look at the first two -- and you go through it page by page. You show what happened. You show what you're paid. You show them what is going on with their accounts. And if they ask how much you got paid, show them your comp statement. Then there is no doubt who is getting paid, why you're doing it, what you're doing it for.

We need to protect our whistleblowers. It's called whistleblower protection programs. DOL manages I think 22 now, okay? It's called whistleblower protection, not crime scene investigation after the fact.

So I think Christine Lagarde said it best. She's the head of the IMF. She said it's called the financial services industry. It's a service industry. It should serve others before itself.

MR. HAUSER: Okay. So let's maybe stop right there, and we'll move to questions. Thank you very much.

You know, Mr. Campbell, you had such an lengthy list. Each item on it, I think, would have -- you know, would take up an enormous amount of time, and I really don't want to do that. But I do want to ask you about a couple of things. The first is, you know, there have been -- I mean, I assume that the Chamber would welcome -- and I just wondered to what extent this resolves in your mind some of the concerns about small businesses' access to fiduciary advice.

But a number of people have suggested, one, that at least in the plan context, that we go back to a rule that says that when you give somebody an asset allocation, you can illustrate the suggested allocation with the specific items on the front menu as long as you include all of the designated options on the front menu that fall within that category, at least assuming the fiduciary overseeing the fund is independent of the advisor, and the advisor doesn't have an interest, you know, as between the various funds on the fund menu.

Does that, you know --

MR. CAMPBELL: Well, I have to say, I got a little lost in the list of your conditions there. If what I heard you say is that advice can be provided with asset model -- asset allocation models and corresponding investments that meet each of the asset classes, yes, I think that's exactly what we think --

MR. HAUSER: If you specify all of the designated -- all of the options that fall within each of the classes under the plan, I mean, starting there and --

MR. CAMPBELL: I think that would be perfectly reasonable to provide the -- all of the investments available in the plan menu that fit that. If what you also said is then anybody couldn't be including any of the options related to the provider who is related to the education, that I think is a restriction that's unnecessary because again, the asset allocation model is not a fund-level recommendation. It simply allocates -- it's talking about a model allocation to a class. So if that class happens to include an investment that's related to the provider of the education, I don't see that as a conflict that's of the sort that this regulation is intended to address.

MR. HAUSER: I see. And, I mean, just asking about the seller's exception, you're -- you know, you and, as I noted on the previous panel, a number of people have drawn a sharp distinction between a sale on the one hand and advice on the other. And I guess I'm just going to confess I don't understand the distinction.

To me, these -- you know, they go -- you can both have a sale, and you can have, you know, advice connected with that sale, and the question I have is if somebody is holding themselves out as essentially as an investment professional, and if they're giving, you know, the sort of advice that rises to the level of a specific investment recommendation in kind of the FINRA sense, why would -- and they're getting a fee in connection with that. Why should there be any additional carveout from the obligation to act in the customer's best interest?

MR. CAMPBELL: Well, you've said a couple of interesting things there.

One, you used the phrase "a customer's best interest." That's not what you're actually talking about in this proposal. You're talking about ERISA fiduciary status and the accompanying effects of the prohibited transaction rules, which is in my mind a separate question from what is in the best interests of the participant.

As you well know, under ERISA, I can make for you what is, by anyone's estimation, the best possible recommendation for you, and it nonetheless be prohibited for me to do so simply because of the structural relationship I have with the investment or with the client.

That's where the ERISA standard, the ERISA fiduciary standard, as well as the prohibited transaction standard, goes well beyond the question of what's in the best interest. That's why we have presumably the BIC exemption and a whole host of other exemptions. It goes right to the nature of your question, which is sales activity has, associated with it, relationships that are not permissible typically under an ERISA-prohibited transaction regime. That's why you have the exemptions to allow that activity.

So it's not a question of, why can't I act in the best interest while being a salesperson. I believe that I am acting in your best interest when I'm being a salesperson if I'm doing that job properly. The problem is ERISA doesn't view those as two separate questions -- or as one question. They're two separate questions.

MR. HAUSER: I'm not sure I -- so if the exemption essentially mandates that you act in your customer's best interest, and it's essentially calibrated to achieve that, but in a workable way, as I understand the Chamber's position at this point, it would still be objectionable to the Chamber to subject, you know, the advisor in that circumstance to any fiduciary obligation. So why?

MR. CAMPBELL: Well, again, that's not what I said. The issue isn't whether they're acting in the best interest or whether that's a prudent fiduciary recommendation. The question is that as a salesperson, can I in fact engage in that activity without running afoul of the prohibited transaction rules, separate from the quality or utility or value of the recommendation itself.

MR. HAUSER: Right. But then -- I mean, and the answer is under the statute, if you give investment advice for a fee to a plan or an IRA, you're a fiduciary. And the Department of Labor's charge and the default is that, yes, you're prohibited from giving that advice on a conflicted basis. It's the Department's charge to then write exemptions to the extent that they're appropriate.

And I guess my question is what you're saying is that, as I understand it, that when the person makes --

You know, even when the person makes an individualized recommendation in a context where they're holding themselves out as an investment professional, and the plan customer is looking to them for professional guidance, that there are still circumstances that you would call sales in which they should neither have to give prudent or loyal advice under ERISA's fiduciary rules, nor should they have to comply with any exemption, even if that exemption were to do nothing but require them to adhere to the prudence and loyalty obligations. Isn't --

MR. CAMPBELL: That's not what I was saying. What the --

MR. HAUSER: Well, but is it correct? I mean, let's --

MR. CAMPBELL: Well, the word that you used earlier, which I think is an important one, is "workable" with respect to the exemption. The question is can I, acting as an agent for a particular brand of products, for example, nonetheless make a prudent recommendation, even though I'm only an agent for that narrow brand of products.

And if an exemption is written in such a way that I can go ahead and do that, I can be compensated for it. We would want appropriate disclosures and so forth. Then that's an entirely different situation than saying: does the BIC exemption do that? Which I don't think the BIC exemption does.

MR. HAUSER: Okay. So in concept, you don't have a problem with our imposing a fiduciary obligation, at least in that circumstance, if the exemption works?

MR. CAMPBELL: If by fiduciary you mean that I'm making a prudent recommendation, again which we've been throwing around the phrase "best interest," certainly. If what you mean is that it has to have an exclusive duty of loyalty such that I'm not able to represent a narrow employer for whom I'm an agent, or that I can't be appropriately compensated for that, then, no, I don't agree with it.

The question is what do you mean, and that's what the whole issue is, is what is workable.

MR. HAUSER: Well, you can be appropriately compensated. But --

MR. CAMPBELL: And to that point, if I could just say, we've had a lot of exchanges over the course of the last two days in which the Department has said, well, of course we didn't mean that, of course you can do X, Y, and Z. The reason in the comments we brought up questions where we perceived ambiguities is not because we just wanted to have fun and be here.

It's because the problem is we have to adhere to these regulations by the letter. So where there is ambiguity, that's potential legal liability. It's a potential inability to know what the actual compliance obligation is.

So I appreciate you saying that. I'm just saying unless it's written down in the final rule, it's very hard for us to just accept, oh, well, of course you intended for us to be able to compensated. The question then is when and how, and how does that work in practice, and what is the legal liability associated with those decisions.

MR. HAUSER: So there are multiple levels of ambiguity in a process like this. I mean, the purpose of the notice and comment process in significant part is to ferret out people's concerns about, you know, the initial proposal, and then make revisions to respond to perceived ambiguities. And, you know, obviously there are both ambiguities that I think are legitimately identified that need to be clarified. There are ambiguities, to be completely blunt about it, that are talking points to be used in advocacy efforts to defeat the rule.

We're trying to respond to all of these

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

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

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

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

MR. HAUSER: No. And I understand the perceived need for a broader grandfather provision, and that's certainly something we're looking hard at. I'm just wondering conceptually if when you're thinking about what a seller's exception would look like, would it ever encompass an arrangement in which part of the fees on an ongoing basis include something that's being denominated as an ongoing payment for advice? Because that is the rationale for a lot of the grandfather relief requests.

I mean, it seems to me if you think there is a distinction between sales and advice, then would it really -- shouldn't that be problem -- shouldn't it be problematic to give a seller's exception that extends to a compensation stream that is for advice?

MR. CAMPBELL: Well, I think that's an interesting question. I haven't thought about that. That's something that we can certainly look at. I'm not sure off the top of my head I can conceive of an example of exactly what you're referring to, but that's certainly something we can look at and discuss later.

MR. COLLINS: Well, I can. I managed about $17 million, and I think I had 6 million in wrap. And that was in an average of like 90 basis points. And I usually talk to clients at least twice a year. Some clients I talk to once a month. And I always know what was going on. I always kept updating to make sure that we were still in the right place.

I don't know how people handle 600 to 1,000 clients, but I got fees for advice because I advised people on the six key areas of financial planning. And I got a fee for assets under management, okay? But if they're getting a match on their 401K, why would you roll it over? It's -- I think it works as long as you're taking care of the client and doing the right thing for the client.

MR. HAUSER: So let me just -- Mr. Campbell, let me just -- I mean, I don't want to beat this dead horse much more than it's worth. But, you know, trailers are commonly, you know, rationalized in that fashion. And on page, you know, 38 of the July 17, 2015, you know, letter from the Chamber, they refer to the fact first in many cases customers that paid an initial sales charge for which they purchased advice.

I'm just curious, you know, how that interacts with the seller's exception because it seems like there is a little bit of a consistency issue there. If any transaction would be subject to the seller's exception, that would also be one that earns this kind of ongoing charge. But anyway --

MR. CAMPBELL: Yeah. Well, in the comment letter, we were addressing the transition rule. And what we were saying there is on some date certain, universally everything must change, except for one limited transition rule in the BIC exemption, which is only available for assets that are on the special list.

So we were pointing out that this transition rule makes no sense in that it's going to apply asset by asset, not by account, only for ones eligible for BICE. And on top of that, you were essentially, by not having any transition rule, disrupting contracts that two parties had made in good faith that were valid under current law. And if that included things like paying for advice, a front-end load to pay for advice on the back end, that disrupting that contract would deny participants the -- or IRA owners or whomever the benefit of the bargain they had made.

So that was the context in which we were offering that comment. That's why I said I hadn't thought about it in your -- in the context of our question. But it's something I'd certainly be happy to get back to you on.

MR. HAUSER: Understood. And then this is my last question, although it does have two parts. So on your observation that there should be a mutual agreement to trigger fiduciary status, there are two issues I have with respect to that concept.

The first is just the danger of abuse, I mean, that essentially it enables somebody to hold themselves out as an investment professional upon whom their customer can rely and, you know, have a whole set of communications maybe extending over quite a bit of time, all of which are proceeding upon this relationship of trust.

But then in the text of an agreement somewhere, you know, write language along the lines of, you know, that the guidance that I've been providing should be viewed as educational in nature, not individualized, and not intended to serve as a primary result basis for your investment or tax planning decisions. And now you can say it wasn't mutual.

That worries me. And I wonder if you think the mutuality in any sense turns on that kind of provision and agreement or that kind of disclosure, how we guard against abuse. And the second is just a legal question, which is while certainly one can agree to be a fiduciary, ERISA's great innovation in the fiduciary definition is that usually fiduciary status turns on a functional activity.

It's not a question of did you or didn't you agree to something. It's a question of did you do the thing that makes you a fiduciary. And in this statute, it says, gave investment advice for a fee to a plan or an IRA. That's fiduciary activity. There is no agreement requirement in that text.

So if you could just respond to those two observations, and then I'll turn it over.

MR. CAMPBELL: Yeah, no. First of all, that's a very good question. I don't think the intent of anyone who is objecting to the removal of mutuality from that definition is saying, yee-haw, this is a great way to get out of the contract by saying, nope, it's not mutual. That's not the intent at all.

The concern is rather the opposite, that because of -- particularly when you combine it with the "specifically directed to" language, if I have a current client, and I send them a letter in the mail that's addressed to them by name, that discusses, you know, hey, here is a new investment we have available, maybe you should give me a shout and we'll talk about it, is that now fiduciary advice that's unilaterally --

MR. HAUSER: No. That's not fiduciary advice. And our education definition clearly says it's not. Really, it's -- as does the definition of what counts as advice. It has got to be a recommendation, which essentially means a call to action, a suggestion that you pursue a specific investment or a specific investment strategy.

So clearly you can talk --

MR. CAMPBELL: So just to be clear, so you're -- I just want to make sure I understood this because this wasn't something that we were able to divine from the proposal.

MR. HAUSER: Oh, no --

MR. CAMPBELL: The Department's position is that it has to be the FINRA definition of recommendation under your --

MR. HAUSER: Well, the Department's position as articulated in the regulation is that first it has to be a recommendation. That's what the -- that's what the rule literally says. It uses the word recommendation.

There is a definition of recommendation in the rule, which uses -- you know, which refers to -- let me see if I can actually just pull the thing out -

- which refers to something that -- a means of communications based on content, context, and presentation would be reasonably viewed as a suggestion that the advice recipient engage in or refrain from taking a particular course of action.

And then further in the preamble, we explain that we used FINRA concept as a touchstone, and we specifically ask people to comment on whether we should adopt the FINRA recommendation.

So that's not just an ambiguity. That's something we laid out for people and tried to make as clear as possible. We do keep hearing from folks that even a casual conversation in which there is nothing approaching a recommendation would be covered by this rule. But that at least is plainly not correct.

MR. CAMPBELL: Well, I think that's a helpful clarification. I would technically note that saying, "we use this as a touchstone, and we ask the question as to where they actually apply it," is different than saying, "it actually applied in the regulation." Either way, I think that's a helpful clarification that's appreciated.

The broader point I was making, though, is that when we have a new term like specifically directed to, we have to figure out what that means.

And so if it can be a unilateral act to make a recommendation by virtue of terms like this that we haven't seen before, that's a concern because it makes it difficult for either party to know when in fact fiduciary advice has been provided or relationships have been established.

And so that's -- our view is, mutuality is inherent in any contract, and therefore ought to be included in this as well.

MR. HAUSER: And if we adopt that recommendation concept as articulated by FINRA, you don't have that mutuality of agreement concept there, do you ?

MR. CAMPBELL: Well, I think at the end of the day, there is enough -- I think there is benefit to including it because at the end of the day, what it really means is would an objective third person looking at this identify that these two parties intended to engage in this activity. To me, that's what a mutual understanding is. And I think it should be in the contract.

I think when you take it out of the definition, it indicates that the Department is saying something that's inherently different about this relationship than it was before. And I don't -- you know, when I see a change in a regulatory definition, I ask why. What is different about it. And to me, that's the purpose of it.

MS. LLOYD: So there has been some conversation on this panel about the list of assets in the best interest contract exemption. And I wanted to ask you, Mr. Campbell -- you said a couple of times that the exemption prevents advisors from discussing certain assets. And I was wondering if you could explain what you mean by that, how the exemption would work to prevent that from happening.

MR. CAMPBELL: Yeah. The exemption is conditioned on advising regarding assets, and assets are defined as a list of specified assets. Those assets that are not on that list -- therefore, if the advisor needs the BIC exemption to give the advice, they can't effectively advise on assets not on the list, or else they're committing a prohibited transaction.

MS. LLOYD: Okay. So it's not that it prevents it. It's just that we are not proposing an exemption to permit advisors to recommend those assets.

MR. CAMPBELL: I would say that's a sophistry. If I can't do something without committing a prohibited transaction, then your creation of the list is preventing me from doing it.

MS. LLOYD: Well, but can't you recommend it in a non-conflicted compensation structure?

MR. CAMPBELL: Yeah. I didn't say that you couldn't advise on it. I said the exemption prevents you from advising on it. If you don't need an exemption, obviously you can advise on whatever you want. If, however, you need the BIC exemption, then you have to advise only on assets that are on the list. And again, our concern is we see absolutely no reason why you would limit the list in the first place.

The BIC exemption, as you proposed it, would already result in no unlevel compensation, no differential compensation for that advisor unless it's related to a neutral factor.

I would argue that's an example of the ambiguity that would result in more litigation. But nonetheless, there is no additional protection that list provides. I view it simply as the Department asserting its own views as to what the right investments are. And I think that's in contrast with the entire history of ERISA and the statute, and an inappropriate step.

MS. LLOYD: Well, could I ask the other panelists if they agree with that? I think that has been addressed in some of your comment.

MR. HALL: Yes. On behalf of Better Markets, we think that the list of permitted assets under the BIC is appropriate and necessary. And I think philosophically it arises from the fact that this is an exemption. And it is necessary then to design a set of layered protections to safeguard investors because basically a conflict has been allowed to persist.

With respect to the particulars, I think to your point, there certainly is -- investors who really want products beyond the list can get them. And in fact, advisors who want to recommend them can recommend them. And there is a variety of alternatives from both sides of that coin to make assets beyond that list eminently available.

I think the list is broad, presumptively broad enough to accommodate most investor needs. I'll note that in the release, there is even the suggestion that if there are products that meet the essential criteria, which is transparency, liquidity, and fair pricing, then members of the industry could come forward and seek to address those separately. I think it's an appropriate restriction.

MS. LLOYD: Well, I was going to see if Mr. Collins wanted to --

MR. COLLINS: I haven't seen the list, but if you don't understand what it is, then don't sell it. Non-publicly traded REITs, they don't pay were pushed on me for 11 years. I never once sold them. I didn't consider them because they weren't liquid. I didn't make the decision because I got to meet quota, and they pay 7 percent. That's conflict.

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

MR. HAUSER: Maybe, Mr. Hall, if I could ask you one more question. I'm just thinking about this, this notion that we should permit people, when they're giving asset allocation education in the plan context, to couple that with the specific, you know, fund options that are on the plan lineup, as long as they include all the fund options that match that asset allocation. Is that something that you think make sense, or is that something that concerns you?

MR. HALL: I think that on the relative scale, that's an adjustment that would cause less problem than some others that might be considered regarding the rule.

It's an improvement, in short. We still would have the concern because as the release explains -- and we embrace this thinking -- if you have an allocation model, asset allocation model, and you populate it with specific assets, even if they happen to be to the extent of what is available in some sense, you are still confronted with the essential reality that that's tantamount to a recommendation.

MR. HAUSER: Okay. Thank you very much. And thank you all.

MALE VOICE: Thank you.

(Pause.)

MR. HAUSER: Last panel for the day.

(Pause.)

MR. HAUSER: Whenever you're ready.

MR. McSHEA: Do you want me to start?

MR. HAUSER: Sure.

MR. McSHEA: Okay, great. Thank you very much. Good afternoon. It's the last panel after two long days, so we appreciate your time and patience. My name is Greg McShea, and I serve as the general counsel for Janney Montgomery Scott. We're happy to be here and grateful for the opportunity to offer our firm's perspective on the Department's fiduciary proposal.

Prior to today, our firm has been actively involved in the Department's rulemaking efforts since 2009, working closely with our securities industry peers to develop a higher standard of care that is satisfactory to everyone, to all parties involved, regulators and regulated alike, and most importantly the retirement investors that all of us are here to serve.

At the outset, I'd like to make it clear that while Janney is opposed to the proposal as written, and as reflected in our comment letter, we are undeniably in favor of a uniform higher standard of care, one that will apply to all investment relationships, not just individual retirement accounts, or IRAs.

So by way of background, Janney Montgomery Scott is one of the oldest full-service financial services firms in the country, tracing our routes back to 1832. For over 183 years, our firm has been providing investment advice to the very constituents that this proposal is intending to address. We have done so, we believe, by endeavoring to act consistently in the best interests of our clients, regardless of the technical legal standards of care that might apply.

Ours is an advice business. And while we have other business lines, our primary business is serving those individual clients and families that this rule is intending to address. We're not the biggest firm, and you've heard from some today who are bigger than us. We're not the smallest firm. You've heard from others that are smaller than ours.

As a middle market, regional broker-dealer, we have 740 advisors who provide tailored solutions in a face-to-face environment, helping the roughly 125,000 families that we serve. Our clients entrust $68 billion in their assets with us, a material portion of which are held in IRAs.

To emphasize the importance that personal advice has on our approach to serving our client base, we do not offer a discount or client-directed, online trading feature. We don't have a robo-advisory platform, and we don't have a centralized 800 number call-in type center for processing transactions. Our model mandates that our clients and financial advisors actually communicate with one another to come up with the solutions that make the most sense for them.

Against that backdrop, my remarks today aren't going to restate the full array of complexities and legal issues associated with the proposal or the companion BIC exemption. My intent is just to highlight from our firm's perspective where our primary business model is predicated on advice how we believe the proposal would actually achieve perversely the exact opposite results of what it's intended to achieve.

Let me begin by emphasizing that Janney supports the DOL's efforts to enhance investor protection. We acknowledge and agree with the DOL's basic desire to adopt a fiduciary standard to apply to IRAs. We believe that a higher standard of care would go a long way to improving the level of trust and confidence that individual investors have in the financial system, and in service providers more specifically.

Investors deserve to have their interests placed first. And in this regard, our interests are aligned. That said, we think that the approach being taken by the Department is unnecessarily complicated. And as you heard yesterday from Mr. Bentsen of SIFMA, the process of getting to this fiduciary standard is probably as important, if not more important, than our shared outcome.

So as written, we believe that the proposal just simply doesn't work, and will have lasting negative unintended impacts as compared to other approaches that have been proffered that can achieve the same or similar result with far less investor confusion, disruption, and expense.

So just a few comments. My first comment would be that we still think it's in the investor's best interest, in the interest of retirement savers, that the Department stand down and defer to the SEC and FINRA to adopt a uniform standard of care that applies to all investors.

Both the SEC and FINRA favor that approach. And as the DOL is aware, SIFMA has proposed a higher best interest standard of care, one that works within the existing regulatory framework, and will be far easier to implement than what is currently proposed.

Respectfully, we don't believe that the process that is being taken by the Department is the right approach to achieving the goal of a higher standard of care. We see the proposal as confusing, increasing costs to retirement savers, and practically eliminating access to investment education, advice, and choice those investors enjoy today, particularly for the smallest retirement savers who need advice the most.

So we would hope to avoid the unneeded

confusion by this proposal, and end up with an outcome that has a uniform standard that applies to all investment accounts, with one set of rules and one set of pricing options for all of our client accounts, both taxable and tax preferred.

At this juncture, with the majority of the securities industry, I believe, in favor of a uniform standard of care, including its regulators, we would hope that the Department take the necessary time to substantively collaborate with the SEC and FINRA to create that uniform fiduciary standard.

The proposal, as we see it, eliminates investor choice, and increases cost. Our business model is predicated on the notion that our clients value the advice that our financial providers -- that our financial advisors provide. We offer our clients a choice. They can either work with their advisor in a fee-based environment, or in a commissioned-base account. These -- and they operate under the Advisors Act of 1940 in the former case, or under the SEC rules and FINRA rules in the latter.

These two legal constructs provide different options and advantages to our customers as they choose. In some cases, clients have both. And at their discretion, our clients are willing to pay competitive rates for that advice based on their chosen account structure -- whether it's commission or fee-based -- that is best suited for them. No different than any other professional service where the value of the service and method of compensation may vary from one provider to another. Whether it's legal services, accounting services, or some other professional services.

As written, the proposal jeopardizes our ability, we believe, to continue providing commission-based accounts to our IRA customers when that may be the preferred and best option for them. IRA customers may then be left with transitioning to higher cost, fee-based accounts, when that may not be preferable; going it alone through the use of low-cost or robo-providers where there is little to no advice provided, notwithstanding the DOL's acknowledgment that IRA investors are in dire need of education and advice; or in the worst case, foregoing any investment advice altogether and withdrawing their assets. And I think we all would agree that that's the worst outcome.

Higher cost advisory accounts are especially problematic for our existing customers, who have chosen brokerage accounts that they prefer. And under the existing structure, to avail ourselves of the BIC, which I submit to you is an unworkable option for us, that would lead today roughly 40,000 of our customers without an option. What happens to those customers, many of whom are smaller accounts, savers just starting out, with limited means?

And the shame of it is ours is a firm that does not segment away smaller client accounts. And we're happy to serve those accounts.

There are a myriad of reasons why the BIC exemption is unworkable. At this juncture, and as it's proposed, we would not avail ourselves of it, the complexities associated with it. If you look at the Deloitte letter that was attached to the SIFMA comment letter, there would be 32 new requirements under the BIC exemption that firms would have to comply with.

Not knowing the magnitude of the liabilities associated with the BIC, the increased costs and regulatory and legal exposure that comes with it, we would not -- we would not avail ourselves of the BIC.

So in conclusion, we believe that there are significant flaws with the proposal, that it will curtail investment education and advice, eliminate choices for our clients today, add unnecessary complexity and confusion into the retirement saving process, and increase costs for retirement saving and investing. The BIC is simply unworkable.

So we appreciate the time, and I'll be happy to entertain any questions you may have.

MS. McNEELY: Good afternoon. I'm standing between you and the end of the day, right? I'm Juli McNeely. I'm the national president of NAIFA, the National Association of Insurance of Financial Advisors. I want to thank you for allowing us to be here today. I'd like to introduce my client, who I have brought with me, Dr. Jen Knoll. She is going to address this panel first, and then I will follow up after her.

DR. KNOLL: Thank you for allowing me to share my consumer experience as a small employer and as an individual investor and retirement saver. I've been a dentist for almost 13 years. That's what I know. I purchased my primary practice, Sparta Dental Center, seven years ago, and three years ago I opened a second location in Arcadia, Wisconsin. I have 12 employees, and plan to hire at least two more soon.

A significant amount of my time and financial resources have been focused on running and building my practices. Because that demands so much of my time and energy, I've relied on other professionals to assist me and provide advice as needed, such as lawyers and accountants and, of course, my practice consultants, and Juli, my trusted financial advisor.

Juli and I have been working together for 11 years, and she is a trusted advisor to me. We've had countless meetings, some that involved a product sale, and others that were simply discussion, idea sharing, and advice.

Some may say that I could handle these financial decisions on my own without Juli. But quite simply, I value her expertise. Juli has helped me understand more about insurance, retirement planning, and investing than I would ever have time to learn and implement on my own.

Working with Juli allows me to focus on what I do best, seeing my patients and running my business. I'm very comfortable with the compensation arrangement that Juli and I have. I'm aware that other compensation models exist. I also know that Juli puts my best interests first. And not only that, she works with all my valued employees who are saving a small portion of their wage via our Simple IRA.

My employees appreciate the opportunity that they have to consult with Juli on an individual basis, and they are thankful that they have a resource to save for retirement with our plan.

I know I have right and responsibility to choose which advisors I work with. I understand that in business, I will pay fees for services provided to me. But I also need advisors that value my time. I'm on my fifth lawyer in seven years because my time hasn't been valued. On the other hands, Juli will take as much time as is needed to explain a product or service. She travels three hours roundtrip to meet with me, and she will work around my busy practice schedules.

I'm so fortunate to know her, and to be here with her today, and I'm really happy to turn it back over to her now.

MS. McNEELY: Thank you, Dr. Knoll. I just want to be clear I'm here representing NAIFA today, which is thousands of other advisors that do what I do. But I do also want to give you a glimpse of my practice so you can get an understanding of where I'm coming from and the filter that I'm using with the comments I'm going to make today.

Our firm has been in existence for 45 years. My father started it 45 years ago. We are located in Spencer, Wisconsin, a town of 1,925 people. I have three support staff and three other advisors who work directly with clients on an ongoing basis.

I also want to make it clear that I am both a fee-based advisor and a commission-based advisor. And that I think is an important distinction. I also want to let you know a little bit about my client base.

I have 52 small business clients, of which Dr. Knoll is one of them. All of those employers have less than 20 -- or the employers have less than 25 employees, and we typically work with them to provide the benefits to their employee base, both in group benefits such as group life, group short-term and long-term disability, and also in retirement plans.

I also have 484 individual clients, again of which Dr. Knoll is one of those. The average account size for my client base is about $71,000. The services that we provide those individual clients is retirement planning, college funding, and investment savings for any future goals that they might have.

The key for my practice is that we focus on creating new savers. We really feel it's important that advice is given to all individuals regardless of the account size that they have. It's important to distinguish that my clients all at this point have chosen the commission-based model. And I think that that's important to keep in mind.

I firmly believe that everyone should have access to advice, and I firmly believe they should also have a choice as to how they compensate their advisor and who they work with on an ongoing basis. I think over the last few months there has been some distinction between fee-based advisors and commissioned-based advisors. We should hopefully all be able to get along, but there are some distinct differences that I want to point out today during my time.

I happen to believe that the fee-based advisors in some ways win with this proposal, and I want to explain what I mean by win. Win from my perspective is that they are going to continue to operate as they always have, whereas as a commissioned-based advisor, I will have to change some of what I do when I serve my clients.

Fee-based advisors also tend to work with wealthier clients. And working with wealthier clients allows you some things that you don't necessarily have if you work with smaller accounts. I would also tell you that one of the things that fee-based advisors tend to do is they tend to not use annuities because their clients, being wealthier, do not necessarily need an annuity because they can self-annuitize.

I've also seen fee-based advisors not recommend annuities because it removes that annuity from their assets under management, and therefore reduces the annual income that they receive. I'll talk more about annuities in a minute.

I'm also not completely positive -- although I've heard some people today say that they would take any size account, I'm pretty sure that many of fee-based advisors would not look at most of my clients' accounts. Like I said earlier, I have a fairly low average when it comes to clients I work with.

My minimum investment is 50,000 to work with a fee-based account, and many of my clients are under that threshold. I personally have 21 clients out of my 484 that have over a half a million dollars in investments, and that's only 4 percent of my total client base.

I also want to just touch on quickly about the costs regarding this proposed rule and the consequences to consumers. One piece that I think has not really been explored completely is the loss of advice, the cost to consumers for the loss of advice that they receive or do not receive as a result of not having an advisor to turn to.

I have clients who come into my office or prospects that come into my office, and they've just left an employer, and they have, say, $5,000 sitting in their old 401K. They don't really know what to do with that account, and we of course coach them through that process, provide them advice, and talk them through what can be a daunting process if you're not familiar with what you have available to you.

If that individual consumer decides to cash out that account, they have taxes, penalties, and of course an even bigger expense of not having anything saved for retirement. That's my biggest concern with the cost of this rule. It's the cost of lost advice over time. I don't believe that anybody should not have access to advice. And anything that we do to hinder individuals from having access should not be done.

I believe that this proposal will result in fewer employer plans, fewer participants in retirement savings account, and I think will lower savings overall. And I know that that is not what the Department has intended it to be.

I want to specifically speak about the BIC exemption because that's really where I operate in my practice, where I would see myself having to fall if this rule went into place. I do think that the BIC exemption is a very confusing thing to clients, and I think we certainly need to look at ways of simplifying that process.

I think it is unworkable, and I think the primary reason it's unworkable is in the implementation. I do think that it's going to be very costly and time consuming. In 2010, I changed broker-dealers, and I went to a new broker-dealer because that broker-dealer offered me some better technology to serve my clients.

During that time, I had to repaper all of my clients. It took my firm about a year to get as many clients as we could repapered done. And it also at that time caused us to lose a good number of our clients. They're still sitting at my former broker-dealer because they refused to sign paperwork. We made multiple attempts to make that happen, and it's just -- some clients just don't like more paper.

So that is a huge concern of mine, is the implementation, and at what point do we have to sign the contract. At the very least, the contract should not be required before the point of sale. I think that's a really important clarification to make.

I also want to talk just briefly about the threat of litigation over the contract provisions, and just touch on a couple of things I could talk more about. I want to touch on a couple of things. I believe the best interest standard will generate some litigation in two specific areas.

One is variable annuities. I think there is some disagreement as to whether variable annuities belong in retirement planning, but I will tell you I have clients who come to me and specifically ask to be put in variable annuities. They list a number of reasons, one being guaranteed income stream.

And when you're looking at middle income Americans, a guaranteed income stream is a very important thing to them. They also are concerned about longevity risk. One of the biggest things I get is a client that's concerned about running out of money. And lastly, I think they want the full upside of the market.

The second piece that I think could cause some additional litigation is proprietary products. I think that many individuals -- consumers work with advisors that have a basket of proprietary products because of the relationship that they have and the strength of that company. And so I think that that could also be a place where we could see some additional litigation.

I would be happy to answer any questions that you have, and I really do appreciate you giving us the time to meet with you today.

MR. HAUSER: Thank you.

MR. PEIFFER: Thank you. My name is Joe Peiffer. I am an attorney, and hopefully I will respect your time here today. I appear here today as the president of the Public Investors Arbitration Bar Association, also known as PIABA. It's an international bar association comprised of attorneys that represent victims of financial abuse. Collectively, our members have seen tens of thousands of victims of conflicted advice.

I myself have represented over 500 such investors. Last month, PIABA submitted a detailed comment letter to the Department of Labor in support of its proposal to update the definition of fiduciary advice under ERISA.

I'm here on behalf of the investors myself and my colleagues have represented. These are people who invariably trust their financial professional. They don't -- they think they're getting advice. They don't think they're getting sales. And I think they can still get advice under this rule. They'll just be getting unconflicted advice.

The vast majority of the retirees that I've seen and my colleagues have seen have placed most of their life savings with the broker. None of the people that I've ever represented realized that the broker might be held to a standard anything below that of a doctor or an attorney.

It's no wonder that investors believe that brokers already have to live up to a fiduciary duty. Brokerage firms advertisements already say things like they will, quote, "not rest until their client knows she comes first," or state flatly, quote, "Our advisors are ethically obligated to act with your best interest at heart." There are dozens of examples of advertising like this.

Academic studies that have looked at this issue conclude what is obvious to anyone that has met an investor that has been the victim of conflicted advice, that is, investors do not know the duties that their financial professionals owe to them.

One thing is clear. Right now, the very same brokerage firms that advertise like fiduciaries routinely contest that they owe a fiduciary duty to clients. We see here today everyone from the financial industry coming up here and saying they're in favor of best interest standards, but when it comes to being called to account for their behavior, they routinely contest that any sort of fiduciary duty exists.

The Department of Labor rule would go a long way towards holding firms accountable in retirement accounts for the duties that these firms already advertise like they have. The lack of this duty has real-world consequences for retirees and investors saving for retirement. The statistics are frankly staggering.

The White House Council on Economic Advisors estimates that 17 billion is lost by investors every year to conflicted advice. That means that since Dodd-Frank asked the SEC to study this issue, investors have lost almost 80 billion from brokerage firms' conflicted advice. I don't think we need to wait any longer.

What does this mean on an individual level? Almost every week we see a retiree come into our office who just lost a substantial amount of their life savings. These are often proud, strong workers that have saved, paid off their house, put their children through college, and built a nest egg, all on modest salaries. These retirees often break down, literally break down, in my office when I explain to them how their money was lost to conflicted advice, and how the broker might not have a duty to put their interest in living a long and happy retirement ahead of the broker's interest in earning commissions.

I've had a client that ran out of money and had to rent a room from his ex-wife. I had a client -- I had clients that lived with me because they couldn't afford the gas and lodging to get back and forth in a protracted arbitration hearing. I've even had clients attempt suicide. I know the devastation that losing your life savings to conflicted advice can have on hardworking Americans. This rule will make it better, and that is why I am so passionate about getting it passed.

An example of how this rule would help. I'll tell you a little bit about a group of Niagara Mohawk employees I represented in upstate New York. These blue collar workers had built up enough years of service that they could live out their retirement by taking monthly pension checks and supplementing that with the money they had saved.

However, the broker advised them to pull their money out of their traditional pensions and roll that and all of their savings over to the brokerage firms. If these investors had left money in their pension plan, the broker would have made no commission, but the investors would have had guaranteed monthly income.

After following the broker's advice, my clients had lost more than half their life savings, had no pension income, but the broker had made large commissions. And when called to account for his advice, the broker and his firm denied they had any fiduciary duty to these clients as to the rollover.

My clients lost this case, and they're now living on Social Security and the small amount of savings they have left. The DOL rule would directly address this problem by making any broker that gives rollover advice a fiduciary. Anyone looking at this from the perspective of a fiduciary would realize that a guaranteed income for healthy folks in their sixties was in the best interests of the clients.

Without such a rule, brokers are free to argue that they met the, quote unquote, suitability standard that is currently in play. They can take their commissions and not worry about being held accountable for whether what they did was in the best interest, and that should stop.

We've all heard from the industry that this rule is too costly, and that it will prevent smaller investors from receiving advice from a broker. However, the statistics don't bear that out. The overwhelming majority of respondents to a survey of financial industry participants said that extending of fiduciary standard to brokers, quote, "would not price investors out of the market for advice."

Indeed, right now there are a handful of states that impose a fiduciary duty on brokers. And there has been studies done on those states, and there is no less access to financial services in states that already have a fiduciary duty. So I believe that argument is a red herring.

But even if you're going to compare costs, I think it's helpful to keep in mind that it is investors that are paying dearly for this conflicted advice now, to the tune of $17 billion annually. This rule should help prevent these conflicts on a macro level, and hopefully will lead to less, not more, lawsuits because it will stop it on the front end.

The members of PIABA and myself see the effect of this conflicted advice on an individual level. One of my clients worked at a chemical plant for a major corporation at an $80,000 a year job, until he got the conflicted advice that he should cash out his pension and roll all his savings over to the broker. He was out of money before he was eligible for Social Security, and he had to take a job at the very same plant he worked at for $10 an hour stocking the vending machines.

This rule won't help him or any of the other retirees I talked about earlier because it's too late for them. But swift action to confirm a strong fiduciary duty will help prevent this from happening to other retirees in the future, and ensure that if it does happen, brokers and brokerage firms that breach this duty will be held accountable.

Thank you very much.

MR. HAUSER: Thank you.

(Pause.)

MR. CAMPAGNA: Yes, I do.

Ms. McNeely, I am referring to your comment in some of these questions. You said that we should exclude any kind of advice about distributions that is not investment advice. We have a section of our investment education provisions that deals a lot with what can be provided without crossing the lines. Are you thinking of -- what exactly are you thinking of when you make -- when you say that there are things that are investment -- related to -- that are related to distributions that aren't investment advice.

MS. McNEELY: That are or are not investment?

MR. CAMPAGNA: Are not.

MS. McNEELY: I'm not exactly sure what you're referring to, but I will say that I believe that the distribution process certainly can have a significant amount of investment advice. I think that's an even bigger reason why you need to have an advisor, because the accumulation phase is vastly different than the distribution phase. So perhaps I misunderstood your question, but that -- to me, you do need advice on the distribution side as well.

MR. CAMPAGNA: Coupled with a specific investment recommendation, or do you see a distinction between the actual advice as to taking a distribution and where you place -- where you're placing that money or --

MS. McNEELY: Well, I think that depends on the client. I mean, when I meet with a client, I have multiple conversations about what their needs are. So do they need liquidity? Are they looking for tapping this money at a later date? So I really think that that depends on the client's situation. I don't know that I could give a blanket statement on that, but certainly the distribution itself requires a thorough look at their situation.

MR. HAUSER: May I ask you about that?

MS. McNEELY: Uh-huh.

MR. HAUSER: You know, both -- and I think you've described to me before your interactions with your customers, and it was nice to hear your testimony as well.

DR. KNOLL: Thank you.

MR. HAUSER: But I think that, as I understand it -- and maybe this is especially with respect to annuity products, that's a fairly drawn-out kind of process. Can you maybe describe a little bit of that? And then -- and just so you know where I'm heading, I'd just like to get your sense of -- I mean, do you view yourself as just as a salesperson? You know, what do you think your relationship is with your customer?

MS. McNEELY: I don't view myself as a salesperson, although we do have NAIFA members that put themselves out there as a salesperson. I view myself as an advisor, and that's how I establish relationships with my clients.

I think as it relates specifically to

annuities, I think they have a very good or a strong purpose to have them in a retirement plan, especially when you're talking to individuals who haven't had the ability to put huge sums of money away. They're more middle income consumers. I think that it provides them certainly a way to annuitize or cover their base living expenses with some guarantees, and that's why I typically use an annuity product in a plan that I put together for my clients.

If they have a set list of monthly expenses, I want to make sure that we cover those so we know they're going to be covered all the time. And then we also talk about liquidity and what they need in an immediate term. So we have separate baskets or things that we utilize money for, and annuities have a very specific purpose from my perspective, and they serve a very specific person -- purpose for a middle income consumer.

MR. HAUSER: And so I guess I just want to maybe describe our thinking a little bit with respect to a business model like yours, and get your sense of it. I mean, we do want to permit, you know, these different kinds of compensation streams to continue. We're not trying to do something that makes, you know, essentially an unworkable exemption for you.

But at the same time, we do think it's important to hold people like you who hold yourself out as an investment professional and help customers to a standard of prudence in putting your customer first, and like that. And that's really the aim. I mean, so I think you believe you already do that.

MS. McNEELY: Uh-huh. I do.

MR. HAUSER: And so what we're really looking for in this contract exemption is just that you make kind of an upfront commitment with your customer that that's what you're going to do. And to make -- and because we recognize the way this market is currently structured and the way the rules work right now, we've also tried to --

You know, we haven't tried to supplant FINRA arbitration, so if somebody were to bring a claim against you, you know, it probably would be heard in arbitration rather than in court. And I would think that minimizes some of your legal exposure.

And we are open to ideas on how to make the contract a simpler sort of document. You know, something may be done closer to the point of sale, something that could be incorporated into an account opening agreement, or something you otherwise do anyway, and maybe with just a notice to your existing customers. You don't have to go through this whole exercise again.

So, I mean, I appreciate your concerns about workability and about maybe the notice provisions and the like. But, I mean, if we get that right, do you think that's going to be a problem for you? If we manage to deal with the notice issues, the disclosure issues, and we get this contract, you know, to a point where it's closer to the point of sale, and it just commits you in a binding way to adhere to these standards, is that something you think you'd be comfortable living with?

MS. McNEELY: Well, first of all, let me just state that I do believe I already put my client's best interest first. I've told you that before.

MR. HAUSER: Yes.

MS. McNEELY: I think that the BIC has some concerns, and I think if we could get to an agreement on these concerns, I think that would go a long way. Number one, I think the timing of when that contract needs to be signed. Does it have to go back to existing clients, or is it just for new relationships going forward?

I do think it does need to be at the point of sale. I think it becomes very cumbersome to have an expectation of signing that BIC prior to making recommendations and/or signing paperwork. That's where I'd rather see it, is at the time --

MR. HAUSER: And our thought if we did that, was that -- while it could be essentially when the money transfers that the promise of the commitment would be the representations you made that got you to that point adhere to this best interest sort of standard.

MS. McNEELY: And I would be comfortable with that. Obviously, I had a good amount of time working with that client, gathering information before I could make a recommendation, and I would be fine with that, that period or that conversation being utilized in that contract.

I think the next concern I have is the definition of best interest. I already talked about in my comments about variable annuities and proprietary products. I have a real concern about those being viewed or a sticky point where there could be undue litigation just because of the nature of those two things.

I also think that the contract -- the BIC right now is --

MR. HAUSER: I'm sorry. Which two things

are --

MS. McNEELY: The variable annuity. I talked about it in my comments, where some believe variable annuities aren't appropriate. I happen to believe they have -- serve a very strong purpose in a financial plan.

MR. HAUSER: And proprietary?

MS. McNEELY: And proprietary products. Those are two things I think are sticky points.

MR. HAUSER: And I assume you would want us to say something on both points to acknowledge their -- you know, that they can play a legitimate role in certain circumstances. Is that the idea?

MS. McNEELY: I just don't want to leave it up to interpretation --

MR. HAUSER: Okay.

MS. McNEELY: -- because I think that's where we get into a slippery slope.

The second -- the third thing is really the warranties that are currently listed in the BIC exemption. Right now, as an advisor, I don't have that information. That would have to come from the administrator or the vendor of that product. And quite honestly, if I have a client who has three or four products they're utilizing in their plan, I now have to get separate contracts from each of those three vendors, with all of the information.

And that becomes a very cumbersome process for advisors, and I think very confusing for consumers. I also think it's a costly process to implement. I have shared with you the example of my broker-dealer change. I think any time that you have to go through a whole new process, it adds complexity and cost. And I think ultimately that could get passed on to consumers.

And I also think the annuity piece is a really confusing piece. Some annuities fall under 84-24, and some fall under the BIC. And I would prefer to see that be in one under the 84-24. I think that would hopefully clear up some of the confusion because I use annuities in all situations. I talk about the different kinds of annuities with every client, and we determine which is best for them.

So those are the main areas I think that we have to be concerned with the BIC exemption.

MR. HAUSER: Thank you.

And, Mr. Peiffer, I don't know if you heard much of the testimony we've had the past couple of days, but a lot of people, not so much on the industry side of the ledger, but on the other side have been very critical of our permitting binding arbitration. Since that's where you do your work, I just wonder what your views are on that?

MR. PEIFFER: Well, my view and PIABA's view is that investors should have the choice to go to court or to have arbitration. In our comment, we chose not to fight on that particular issue at this particular time. I think it's more important to us that we get this rule passed than it is that we end mandatory arbitration.

It would be better for my clients to get -- and better for investors if this rule was in place, even though I think arbitration is bad for clients, too, and bad for investors, too. This rule is important.

MR. HAUSER: And, you know, sometimes, not -- every now and again -- I wouldn't say it's a majority kind of representation from the folks that are coming before us. But every now and again, somebody will say, you know, "there really isn't much difference between the suitability standard and the best interest standard." I wonder if you could just tell me if you agree with that.

MR. PEIFFER: I disagree with that completely. Suitability standard, it says the guidance that FINRA gives is, the requirement that the broker's recommendation will be consistent with the customer's best interest does not obligate a broker to recommend the least expensive security or investment strategy. However, least expensive may be quantified as long as the recommendation is suitable, and the broker is not placing his or her interest ahead of the customer's interest.

Think about that. We had someone from Fidelity up here who said they'd be happy to be held to the standard of a doctor. Now, think about this. Think about a doctor or a lawyer that would be free to recommend a more expensive, less effective, conflicted alternative so long as the recommendation was not broadly inconsistent with the broad direction of the client's health or legal interest.

You couldn't have that. You have to have a fiduciary standard. It's different. And one way you could tell for sure it's different is that every time I called the brokerage firms to account for their misbehavior, they denied that a fiduciary duty exists, and point me to the suitability rule. They wouldn't do that if there was no difference.

MR. HAUSER: Thank you.

MR. PIACENTINI: Ms. McNeely, I'd like to ask you about -- you've made a couple of references now to a recent change in broker-dealer.

MS. McNEELY: Uh-huh.

MR. PIACENTINI: This is something we see a lot in the news, you know, that advisors do change from one broker-dealer to another. I get the sense that there is competition among the broker-dealers to have more advisors come and work for them and bring their accounts and use their services.

You specifically referenced improving the technology that you could use and offer to your clients. I wonder if you could elaborate a little bit on that, but also maybe tell me whether there are other important considerations that might -- you're aware of that might have led you or other advisors to change from one broker-dealer to another.

I know that, you know, they do have different product platforms they might offer you. They have different compensation arrangements.

MS. McNEELY: Well, I did a fairly extensive search when I -- before I made the decision to make this change. And I will tell you, the products that are available from one broker-dealer to the next are not very much different. So that wasn't a factor for me at all.

What really was a factor was this technology piece. My former broker-dealer really didn't have sort of a vision of how they could serve us as brokers and help us better serve our clients. And this -- the broker-dealer that we chose actually had that for us. And for me, that made all the difference in the world.

If I have a broker-dealer who is going to help me with consolidated statements and analyzing existing accounts, providing me better training and education, why wouldn't I want to go with a broker-dealer that does that for me, because then I can better serve my clients.

So it really was about being able to better serve my clientele, and then also just, you know, having a broker-dealer with a vision for moving us forward in the future. It had nothing to do with the products. It had nothing to do with compensation. My compensation was the same in both places. It really was where I saw the future.

MR. PIACENTINI: So it sounds like you were able to deliver better service or service less expensively because of a better technology support?

MS. McNEELY: Well, it cost me a little more as an advisor. I have to pay a technology fee now that I didn't have before. But that is a fee that I think is worth it because it does, like I said, allow me to better serve my clients. It's worth it.

MR. PIACENTINI: Thank you.

MR. CAMPAGNA: Again referring back to your comments, the comment letter, you talked about expanding the seller's exception to have all plans, not just, you know, these sophisticated plans that we refer to. Do you have any idea of what additional conditions or additional notion of sophistication we should apply in that regard, or do you have just a set idea that all plans should be part of the seller's exception?

MS. McNEELY: Uh-huh. Well, I will just start by saying that I am not someone who would be using this exception. So I very much operate in that BIC world, in the advisor world. So I know other NAIFA members, though, that do. And they put themselves out there as a salesperson, and have much more of a transactional approach to how they serve consumers.

I will say that we'd be happy to work with you on getting you additional information, specifically how we would like to see the seller's exception changed and modified. But that would be something I'd like to follow up with you on, if that's okay.

MR. CAMPAGNA: And with respect to the education exception.

MS. McNEELY: Uh-huh.

MR. CAMPAGNA: You were saying that this should basically go back to 1996, when we included reference to specific investments. There has been a great deal of discussion regarding what if a plan fiduciary approved the options. Couldn't the investment allocation also include the investments that the particular fiduciary approved?

Do you have any views of that? And how would that apply in the IRA marketplace or for directed brokerage?

MS. McNEELY: Well, I think that from my perspective education is certainly something that leads up to a product sale or an agreement between you and the client to move forward.

I don't know that I would ever at any point want to stop in a discussion and have something signed. And so I think we as advisors should be able to advise our clients, educate our clients up until that point. And once the decision is to move forward, then I think we obviously have to comply with one of the exceptions that you referred to.

So I would say from my perspective, the education piece needs to be a little bit broader than what your current rule states. And I think that we have to have the ability to educate both on the plan level and on the IRA level to the point to we take them to making a decision on a recommendation given.

MR. HAUSER: All right. Well, we thank you all very much for your help. And that ends today. We're back, I think, at 9:00 again tomorrow. Somebody is back.

(Whereupon, at 5:02 p.m., the public meeting in the above-entitled matter was adjourned, to reconvene at 9:00 a.m. the following day, Wednesday, August 12, 2015.)

REPORTER'S CERTIFICATE

DOCKET NO.: N/A

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

HEARING DATE: August 11, 2015

LOCATION: Washington, D.C.

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

Date: August 11, 2015

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