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)

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

Wednesday,
August 12, 2015

The parties met, pursuant to the notice, at 9:01 a.m.

ATTENDEES:

Government Panel:

TIM HAUSER
Deputy Assistant Secretary for Program Operations

CHRISTOPHER COSBY
Office of Policy and Research

JOE CANARY
Office of Regulations and Interpretations

LYSSA HALL
Office of Exemption Determinations

WILLIAM TAYLOR
Office of the Solicitor
Plans Benefits Security Division

JOE PIACENTINI
Office of Policy and Research

LOU CAMPAGNA
Office of Regulations and Interpretations

ATTENDEES: (Cont'd.)

Panel 14:

On behalf of American Council of Life Insurers:

JAMES SZOSTEK, Vice President Taxes & Retirement Security

On behalf of Pension Rights Center:

MARIA FREESE, Senior Policy Advisor

On behalf of TIAA-CREF:

EDWARD MOSLANDER, Senior Managing Director

Panel 15:

On behalf of Association for Advanced Life Underwriting:

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

On behalf of Farmers Insurance and Farmers Financial Solutions:

JOE WIMPEE, Farmers Agent

On behalf of National Active and Retired Federal Employees Association:

RICHARD THISSEN, National President

Panel 16:

On behalf of American Bankers Association:

GERALD P. CLEARY, Senior Vice President
Northern Trust Company

On behalf of Center for American Progress:

JOE VALENTI, Director of Consumer Finance

ATTENDEES: (Cont'd)

On behalf of Russell Investments:

JEAN-DAVID LARSON, Director, Regulatory and Strategic Initiatives

Panel 17:

On behalf of American Retirement Association:

MARCY SUPOVITZ, President-Elect

On behalf of The SPARK Institute, Inc.:

TIM ROUSE, Executive Director

Panel 18:

On behalf of Americans for Financial Reform:

DR. MARCUS STANLEY, Policy Director

On behalf of Financial Services Institute:

DALE E. BROWN, President and Chief Executive Officer, FSI
W. MARK SMITH, Sutherland Asbill & Brennan, LLP

On behalf of Indexed Annuity Leadership Council (IALC):

JIM POOLMAN, Executive Director

Panel 19:

On behalf of CFA Institute:

LINDA RITTENHOUSE, Director, Capital Markets Policy-Americas

On behalf of Committee for the Fiduciary Standard:

KATHLEEN M. McBRIDE, Chair

On behalf of Davis & Harman, LLP:

KENT A. MASON

ATTENDEES: (Cont'd)

Panel 20:

On behalf of Committee of Annuity Insurers:

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

Empower Retirement:

EDMUND F. MURPHY, III, President

On behalf of Capital Group Companies:

JASON BORTZ

I N D E X

STATEMENT OF PAGE

P R O C E E D I N G S

(9:01 a.m.)

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

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

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

Panelists will be allowed 10 minutes each to present your testimony. Please try to stick to that. We just have so many people who wanted to speak about this and would like to get through in a reasonable amount of time. Each of you will get to testify first, and then the government panel will ask questions. We won't accept questions from the audience.

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

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

Let's see. After this hearing we have already reopened the comment period. We will keep the rulemaking record open for another two weeks, you know, after the hearing transcript is posted. Again, all public comments and written testimony will be made available on our website.

Our hope/plan is to break for lunch at 1:15. I know there's a temptation to get up at 12:15 and go for lunch, but there will be one more panel at that point, so stick around.

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

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

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

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

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

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

The agencies have helped to clarify how annuities can be embedded within investment options, and we understand the Department is exploring how 401(k) benefit statements could be improved by illustrating the value of participant account balances as monthly income for life. We agree that these steps will help to improve 401(k) plans for savers and retirees.

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

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

This proposal needs material changes. Our comment letter details the changes necessary to ensure that retirement savers and small businesses continue to have access to savings arrangements and guaranteed lifetime income products. As the Department is well aware, annuities offer 401(k) retirees a way to supplement social security and receive additional income guaranteed to last throughout their retirement, a personal pension if you will.

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

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

Everyone benefits when there are more workplace pension savings and welfare benefit plans, when savings rates improve, when service providers intervene to discourage leakage to preserve savings for retirement and when there is access to an education about the key role annuities can play in retirement planning.

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

Today, too few 401(k) plans offer annuities. In most cases, to access guaranteed lifetime income retirees must roll over to an IRA. But how will they know to do that? As the Department is aware, much has been written about the annuity puzzle. Given the benefits of annuitization, why don't more people choose annuities?

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

Second, research indicates that people

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

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

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

Thus, the dilemma. The focus of the proposed regulation is the elimination of financial conflicts, that is conflicts that exist due to differences in compensation between the sale of one product over that of another. ACLI members are greatly concerned that as currently drafted the proposal will drive financial firms to move to levelize compensation arrangements in a way that will no longer appropriately compensate financial professionals for the sale of annuities and other insurance products.

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

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

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

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

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

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

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

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

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

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

MR. HAUSER: Thank you.

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

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

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

I know you've heard a litany of complaints from various segments of the financial services industry about how the rules are unworkable and that middle income Americans and communities of color will suffer grievous harm if the proposals are implemented. We at the Center would point out that every single consumer oriented group with an interest in retirement security who represents these communities has expressed support for the proposals, while the opposition has come exclusively from an industry with billions of dollars at stake in maintaining the status quo. We should be wary when the lion claims to represent the interests of the lamb.

I would also point out that for groups such as the Pension Rights Center, your proposed regulations already represent a significant compromise. Retirement assets are unique, and Congress has dedicated billions of tax dollars to encourage workers to save for their retirement, yet there is a $7.7 trillion retirement income deficit in this country, which is the gap between what Americans have saved to date and what they should have saved to have a reasonable standard of living in retirement.

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

We've submitted more extensive written comments, so my statement will focus on three issues. First, that the inclusion of advice concerning plan distributions in IRAs is essential; second, that a facts and circumstances test is appropriate for determining whether a person rendering investment advice is a fiduciary; and, third, that the exception to the regulations are appropriate and well considered.

First, advice concerning distributions in IRAs must be included. The decision on whether to take a lump sum distribution from a plan can have profound effects on a person's financial security and retirement. In some cases the decision to move assets from a defined contribution plan to an IRA can result in the retirement saver paying higher fees for the similar investment assets and can also result in loss of access to plan investment options that may not be available in an IRA.

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

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

The financial service industry's arguments are, to say the least, contradictory. While they insist that knowing the cost of advice will act as a disincentive to savers, who will forego advice rather than knowingly pay for it, they suggest that brokers and other advisors are completely immune to financial incentives offered to promote certain investment products.

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

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

We are concerned that this reference may be interpreted as requiring bilateral or shared understanding by both a retirement investor and the advisor that advice is being directed toward the advice recipient. This interpretation could send us back to the current regime where a boilerplate disclosure indicating the advice is not intended to be relied on exclusively by the investor insulates the advisor from fiduciary responsibility.

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

Third, the proposed exceptions and

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

While we strongly support the BIC, we believe there are ways to strengthen it for consumers. For example, the Department should clearly provide that the exemption applies to rollover advice provided by either a third party call center or advisors not affiliated with the plan. While we read the exemption to clearly cover this advice, we understand some in the financial services industry have raised questions about its applicability.

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

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

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

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

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

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

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

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

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

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

MR. HAUSER: Thank you. Mr. Moslander?

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

TIAA-CREF is the leading provider of retirement plan services in the not-for-profit and higher education markets and a global asset manager with more than $869 billion in assets under management. We were founded nearly a century ago to operate on a not-for-profit basis with the mission to serve those who serve others and to aid and strengthen our client institutions.

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

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

In the time I have today I'd like to focus on two points in our letters. First, I would like to underscore TIAA-CREF's agreement with the Department that individualized distribution advice, including whether to receive a lifetime income distribution from an annuity or to roll over from an employer sponsored plan to an IRA, should be subject to the very same fiduciary standards as all other advice. We do, however, offer some technical recommendations in this regard. Second, I'd like to highlight our concern with the proposal's impact on the Department's goal of fostering lifetime income solutions.

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

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

Participants often benefit from institutional share class pricing, which generally keeps fees lower than retail shares. Plans that choose TIAA-CREF can provide in-plan, built-in lifetime income features. This results in higher annuitization rates and improved retirement outcomes. And participants often benefit from allocating money over time to fixed annuity contracts with historical interest crediting rates that can be higher than rates any new investment can offer.

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

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

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

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

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

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

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

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

Given our mission, we're grateful that the Department has undertaken significant efforts in recent years to promote guaranteed lifetime income, but unintentionally the proposal risked doing the opposite. Because annuities are complicated, sometimes cost more than mutual funds due to both their income level and lifetime income guarantees and are sold on a proprietary basis, we fear the proposal will discourage the use of guaranteed lifetime income solutions.

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

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

Without the ability to discuss specific annuity options, it would be very difficult for us to provide participants and IRA owners with sufficient context to understand the benefits of annuity products that guarantee participants will never run out of money.

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

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

TIAA-CREF only sells proprietary annuity products. These include the in-plan and individual annuity options through which we provide plan participants and IRA investors guaranteed lifetime income. But by inhibiting insurance companies from exclusively selling their own products, the Department would only decrease the availability of guaranteed lifetime income products.

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

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

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

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

MR. HAUSER: Even worse.

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

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

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

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

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

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

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

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

It's not prohibited advice and it's not problematic unless you've crossed that line and actually recommended the specific -- you know, you've really recommended that the person take a particular course of action. And I just read to you from the education provision, and ask, you know, assuming I can find it, and ask where you think we fall short or what you think we need to add to it.

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

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

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

MR. HAUSER: Okay.

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

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

MR. SZOSTEK: Can I add to that?

MR. HAUSER: Sure.

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

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

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

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

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

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

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

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

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

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

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

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

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

MR. SZOSTEK: Is that a question for me?

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

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

And combined, as Ed said, you know, it's the totality of this proposal, so I've got an affiliation rule that calls into question whether or not the insurance carrier itself is a fiduciary and then that implicates all the revenues, every dollar or dime the insurance carrier receives or earns on any of its work.

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

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

If you don't have those kind of recommendations you need not even look at the

carve-outs. You have no need of a carve-out. So maybe to the extent carve-out has suggested to somebody a negative implication that even if you don't fall within that definition you're out of luck that's unfortunate and we should fix that.

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

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

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

MR. MOSLANDER: We would support that.

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

MR. SZOSTEK: Yes. Yes.

MR. HAUSER: Okay.

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

MR. HAUSER: Absolutely.

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

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

So the notion that somehow a sales activity or a presentation or any of these things can be distinguishable because there's no relationship of trust once you get to the call of action, that's another thing that we're a little concerned about that we want to make sure that there's this understanding that you are developing a relationship of trust and that raises the threshold of what the people that are trusting you have an expectation about.

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

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

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

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

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

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

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

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

I mean, if you've gone through that kind of process to recommend something as complicated as a variable annuity why shouldn't the recommendation have to adhere to some fiduciary norms to be prudent and be in the customer's best interests and not be something you can disclaim away?

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

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

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

MR. MOSLANDER: We believe that when you make a recommendation you've taken fiduciary responsibility. That's how we deliver advice today, and we take fiduciary responsibility for the advice that we deliver.

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

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

MR. MOSLANDER: Well, if the education

carve-out works as you described it we probably don't have as much issue with the BIC exemption. Our issue is the educational carve-out and the breadth of it and then perhaps the timing and sequencing of when the BIC exemption takes place.

As I said, as we all said, these annuity products are complicated. It takes multiple interactions and somebody may or may not do something based on all those interactions and so it becomes really the timing and sequencing of when, you know, the BIC exemption applies and when advice is being given. If we moved it up to the advice is being given when a recommendation is made that would make things certainly more palatable.

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

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

MR. HAUSER: Yeah. Well, people --

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

MR. HAUSER: Yeah.

MR. SZOSTEK: -- your compensation is reasonable?

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

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

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

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

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

Well, first off that he or she is not making recommendations based on their own financial interest, but rather what's in the interest of the customer and that you haven't created financial incentives or that you've reasonable designed policies and procedures to make sure that that salesperson is giving advice that's prudent and meets the best interest standard and it doesn't incentivize a person to act contrary.

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

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

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

MR. HAUSER: Okay.

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

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

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

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

MR. HAUSER: Well, yeah, but so let's say, I mean, just taking your issue. I mean, suppose we said that reasonable comp is just reasonable compensation in the 408(b)(2) sense, which is what you're already living with.

MR. SZOSTEK: Uh-huh.

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

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

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

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

Again, especially for lifetime income products you won't know what your revenue is until that annuity stream is ended and you see whether or not that particular contract was profitable.

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

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

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

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

But if you made the warranty and you otherwise complied with the contract conditions you haven't violated the exemption because the exemption is conditioned on the issuance of the warranty, not on compliance with that warranty. So I think to the extent some of your concerns, you know, on operability are based on an assumption that violation of the warranty necessarily blows the exemption that's mistaken.

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

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

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

MR. HAUSER: Ten minutes.

MR. CANARY: But they're excellent questions you're asking.

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

(Laughter).

MR. CANARY: But I'll keep trying.

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

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

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

MR. HAUSER: No. I'm asking. We wrote that. The question is if our ask, you know, is that you execute a contract that gives a warranty to somebody that says look, we're not incentivizing this person you're dealing with that's having all these conversations with you about how to invest their money. We do not incentivize people to act in a way that departs from your best interest. Is that something that makes this unworkable from the insurance industry's perspective, because I worry about that.

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

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

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

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

MR. MOSLANDER: Yeah.

MR. HAUSER: Yeah? Please.

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

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

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

You'll end up with a person being able to make aggressive recommendations in a sales position as long as they are clear it's sales. They'll be able to say I'm not intending to provide investment advice and say they're avoiding fiduciary status under the general definition and they'll be able to have education, which puts in specific investment alternatives as long as they say well, there's other options out there for you. I guess that's the same question for all three.

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

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

The educational component, once you start populating with individual products you have to be very, very careful how that is done so that you don't end up creating a situation where people perceive that this is a recommendation because again, you are in an environment where by definition you've already created an environment of trust with these people because otherwise they wouldn't buy from you.

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

MR. CANARY: Mr. Moslander?

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

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

MR. SZOSTEK: And, Joe, the education piece, I think it's important to think about how that can operate. So you could have a variable annuity with 20 investment funds, and so to give them an asset allocation that didn't specify the funds that are in the contract, the international fund was the only international fund, sort of like a 401(k) plan with designated investment alternatives of 10. You know, a fiduciary picked them.

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

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

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

So currently under the general definition of fiduciary if you're outside of the investment advice component and then the other fiduciary provisions there isn't a mutuality requirement. Your status as a fiduciary is more of a functional test, not dependent upon the intent of the person who is engaged in conduct that may make them a fiduciary.

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

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

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

MR. CANARY: And maybe we can have further dialogue because I think what we tried to do in the proposal was focus on conduct that would reflect sort of a reasonable basis to conclude that there was a relationship of trust without putting the status of fiduciary in the control of the person making the recommendation where they could say but I'm not agreeing to provide investment advice.

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

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

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

MR. CANARY: Okay.

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

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

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

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

MR. CANARY: Excellent.

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

Now, there may be a life insurance policy that has investment components in it, but in general we don't see the analysis I think that would be necessary to understand the products, the features, the way the plans operate in this proposal, and we would encourage the Department at the very least to reserve any action with respect to welfare benefit plans for further rulemaking.

MR. CANARY: Thank you.

MR. HAUSER: Thank you.

(Pause.)

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

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

Our firm, ValMark, is a member of the AALU. We're located in Akron, Ohio. We've been in business since 1963, and we're an interesting blend of broker dealer, as well as a registered investment advisor. We have about $14 billion of assets under care, and that is split evenly between the fiduciary fee-based regime, as well as the commission broker dealer regime.

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

My goal today is not to criticize. I'm really here to offer constructive feedback based on real world experience as to how this will impact savers and to also talk about the practical implications of the rule. While well intended, I really do believe there will be adverse consequences. And finally, I'm here to speak on behalf of the clients we serve to preserve their right to make choices that are in their best interest, but as they determine that best interest to be.

Kind of three buckets of information I want to cover quickly. One, I see a really big opportunity to build on the existing regulatory framework; two, some of the conflicting messages that this rule as proposed sends; and finally, what are the implications of those things on consumers.

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

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

You've read those comment letters. I'm not going to spend time on the opportunity there to have them take the lead. To me it's more about how can the Department build on its own framework. And the Department has done an incredible job. I look, I heard 408(b)(2) mentioned earlier, and in 2012 you finalized those disclosure rules and they did three things in their attempts to provide clarity in the market. They disclose the services provided to the customer, whether the capacity was a fiduciary or not, and the cost and fees associated with those services.

And I just would pause and ask has the Department had an opportunity to analyze the impact that those rules have had and if the impact that they've had is towards the outcome that you want, and if not is there an opportunity to perhaps amend those. You know, as someone who is in favor of smart and well-informed regulation, I would say our business data shows that that is working.

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

The reason I share that is just to say that the rules that you put in place seem to be working if the goal is to create in practice more people when given the choice choose a fiduciary standard, and yet those rules preserve the ability for people to choose to operate in a brokerage capacity if that is what they want while the smaller plans are actually more cost efficient. So that's the first category of information.

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

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

It's not hypothetical. It's not general. It's very specific. And I just wonder, the rule as proposed, if you're going to be able -- we're going to be able -- to take action that the GAO recommended as one of the main solutions in the market.

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

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

The Treasury took this report very seriously. Last year they issued qualified longevity annuity contract regulations, final T regs, on using annuities inside of plans. Those products are just now available in the marketplace, and unfortunately the rule as proposed I think it's reasonable to interpret it would prohibit the use of the very solutions that were just proposed last year and the products being made available this year.

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

They've come in with reverse churning and say if you have holdings where you're giving someone advice and building a plan and a part of that portfolio, maybe it's low basis or they have a

long-term need for that asset, you should not put that in a fee-based account. You should put that in a brokerage account. And so they're testing and examining, and this rule will do the opposite and so you wonder when IRAs are overseen by two competing fiduciary standards which would I do in that scenario.

And then finally, the practical implications to consumers, and the first, and you've heard this, the loss of access. And the GAO study talks about the importance of managing longevity risk, market sequence of return risk. AARP said 57 percent of Americans have saved less than $25,000, and that's the area where those risks are most important to manage. They don't have the buffer to withstand the impact on those accounts, and this rule, as kind of a de facto measure, would eliminate much of the opportunity they have to transfer those risks to third parties.

And then I would also say not only do you eliminate the ability to transfer those risks to third parties, that access in general is limited as a result of this. And I know you've read the comment letters. People have talked about the United Kingdom, and I'll admit I'm not an expert on the United Kingdom, but I did note that 10 days ago the Economic Secretary of the Treasury launched an examination into the advice gap that exists in the country or if there is an advice gap and what it is only two years after their rule.

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

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

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

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

And finally, I'd like to conclude with the impact on consumers not only being lost access, but lost choice. I think consumers should have the right to make choices, and if they are uninformed in a particular area or unaware then let's roll up our sleeves and get serious about how we can help bridge that gap.

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

May I take just one more minute?

MR. HAUSER: Sure.

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

But to not allow them a workable way to have access to these solutions, I don't believe that that can be in their best interest. And so in short I would say that we have to allow savers the ability to choose to do things that are in their best interest, but as they determine that interest to be, not necessarily regulators.

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

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

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

MR. HAUSER: Okay.

MR. WIMPEE: Thank you guys. I just want to thank you for the opportunity to speak with you today. My name is Joe Wimpee. I'm the owner and the president of the Joe Wimpee agency in Rockwell, Texas. I may be the only guy here that hasn't been some CEO of some company or something else. I don't know, but we'll find that out at the end of the fourth day, I guess. We appreciate the opportunity just to kind of give you our opinions on the suggested conflict of interest rules too.

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

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

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

I'd like to spend my time here just real quickly to tell you about my business, my customers and how I serve the role as a trusted advisor to them. I have brought with you my written testimony, which you guys will have, that gives our recommendations. We have a proposal for you. We also submitted comments back in July. We will submit additional comments after this meeting to follow up.

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

I've got a small restaurant group. It has about 35 employees. We started a 401(k) plan. So we get them started. They've never invested before. They never had a 401(k). They're restaurant workers, so they're waiters, they're cooks, they're busboys. So they're not the most sophisticated financial people in the world making great financial decisions typically, okay?

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

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

They're not acting because of fear -- fear of picking the wrong fund, fear of making the wrong button pushed on the machine, fear of not understanding the complexities of the process. So I go back out to the manager, set up little meetings with five people at a time. I'll bring paper applications out and let's see what happens.

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

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

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

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

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

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

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

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

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

And so for years I just would send him a piece of information. Here's a little advice. Here's a little advice, just send it to him in the mail, just some kind of information, some study, some something. All of a sudden my phone rings. Hey, I was reading what you sent me, and what you just said, that can't be right, but I believe this. Well, that means he's been reading everything I've been sending him, right?

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

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

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

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

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

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

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

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

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

And so I said calm down, Cathy. Calm down, okay? We've been doing this for 15 years, and you've accumulated $100,000 in your account just by doing what we're doing even through bad times, right? She said yeah. I said Greece is small. It's irrelevant. It's good talking points, okay? Don't worry about China. So we got to that point through it all and so they're coming in next week, but she knew that was not the wrong thing, but for me that's $5,500 in commission versus 200 bucks a year I make off her if I sell the annuity. It's not in her best interest.

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

So I would ask you guys really, and when I say this I say it sincerely. Challenge us. Ask us questions. Use us. Please, please, please study what we do. We are not your normal investment or insurance company, and there's nobody that does it the exact same we do. We have a model that is hard to beat, and I've found that in any competition role, any competitive role I've been, I've found it's been hard to beat. Thank you for your time.

MR. HAUSER: Thank you.

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

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

NARFE is particularly concerned that federal employees and retirees, as well as uniformed service members, invested in low-fee, thrift savings plan funds currently are not adequately protected from bad financial advice regarding their TSP holdings. Because rollovers are not covered by the existing definition of fiduciary investment advice, financial advisors may legally recommend that account holders roll over their TSP holdings into an IRA where the money could be invested in mutual funds providing the same or essentially similar products.

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

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

Nearly half of all current active duty uniformed personnel or more than 700,000 individuals are invested in the TSP. This number is growing we think with each passing year and does not include those with balances who have since separated from the military.

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

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

While there are some legitimate reasons to roll over TSP holdings into an IRA, in most cases federal employees and retirees are better off leaving their money in the TSP, yet more than 50 percent of the TSP participants remove their funds from the TSP within a year when they are separated from service.

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

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

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

Another said I did not receive any information prior to my withdrawal. I received very bad advice from a financial advisor regarding my TSP. In hindsight, I would have probably left the TSP in place.

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

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

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

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

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

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

Thank you again for the opportunity to share our views.

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

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

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

So I would start with the notion that they are prohibited, not expressly stated annuities, but the fact of self-dealing, unlevelized compensation. That's why FINRA's comment letter says this is not business neutral.

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

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

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

MR. CALLAHAN: Sure.

MR. HAUSER: -- but, you know, at its core what the exemption, the best interest contract exemption contemplates is that you agree up front with your customer that when you made a specific investment recommendation it was going to be in the customer's best interest. It was going to be prudent.

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

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

say --

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

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

And I would just question if going through this additional standard on top of the SEC and the confusion I talked about, and whether we agree or disagree the fact that we have questions on loss of access and put all these things together and say is that cost or risk worth the incremental benefit picked up when we have an exemption that, as I read it to be currently, does exactly what --

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

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

MR. CALLAHAN: I would say the confusion, there's two parts, the confusion and then the standard. I would say it does not reduce confusion because now there's a new fiduciary definition, and for many of our clients, as I mentioned in my remarks, they already have an IRA overseen by the SEC and so it sounds very simple to say well, you're already a fiduciary. Isn't this easy? No, it's not. It's two totally different definitions.

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

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

But I would say in supporting the goal, and this is kind of what I want to get back to. Debating studies or hypothetical language, I'm not a regulator. I admit that. But I work with clients and advisors every day, and I think what would be helpful rather than creating this new standard that I just talked about, this confusion that gives us admittedly you could argue stronger remedies on the back end to unwind these deals, if we're really serious about helping consumers on the front end how do we help prevent them from doing things that they would need to unwind?

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

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

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

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

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

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

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

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

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

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

MR. CALLAHAN: Well, I mentioned we do have that with the SEC, but to go with this further, your question, it's not so much that having the standard is the problem. It's the lack of definition around it.

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

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

When you parlay them over, now we've got the situation where a lot of the tools that are used are prohibited and now we're working backwards to carve them out, and I guess on my premise I'm just suggesting that is there not an opportunity rather than adding on this layer and figuring out how we continue to peel this onion back, could we not use the existing framework that's in place and be pragmatic about helping consumers have the information that they need up front on a simple, one-page document that can help them in their decision making rather than give them this ability to unwind it in the future under a higher standard? I'm just not sure it's as practical as the other.

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

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

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

And I mentioned more than half our business is under a fiduciary regime to do what's in the best interest, but in the scenario where you're using these products that are overseen by -- products that are registered with the SEC, overseen by FINRA, it's a bit unfair to quantify that as not doing anything that is in favor of protecting the client. That's a robust regime.

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

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

MR. CANARY: Thank you.

MR. CALLAHAN: Best interest regime.

MR. CANARY: Let me switch gears on you a little bit, but maybe I'll start with the Farmers business model. A couple of questions. From the sounds of the way that you interact with your clients, you may not really have a lot of experience with this, but I have asked other panelists about dispute resolution systems that are alternative to the FINRA model for dispute resolution.

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

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

MR. CANARY: Okay.

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

MR. CANARY: Okay.

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

MR. CANARY: All right.

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

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

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

If you're going to leave it to a grandkid you may want to put it in some kind of contract that gives you a guaranteed return that guarantees a death benefit. I don't know, but they need to be able to pick that. And if they would have had that one-page disclosure instead of all these people calling, nine out of 10, I bet that number would have been down to very little of nothing because they would have slowed down the process.

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

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

So that kind of concept does work. If you'll give us the tools that are simple and not regulate us to a point where it forces me to change my business model and charge more to build and follow regulation, why I'm I then going to pass that cost on to who? Consumers. The consumers end up paying more for services they already can get. I just don't want to see that happen. That's my fear. My fear is I don't want consumers paying more than they are, but get good advice currently.

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

MR. WIMPEE: Yeah.

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

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

MR. WIMPEE: Correct.

MR. CANARY: Okay.

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

MR. CANARY: Okay. And one element of your testimony seemed to be a focus on the fact that your business model and your revenue stream is not really dependent upon investment advice. It's that you're providing other kinds of insurance services -- auto, home, whatever.

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

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

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

Well, mine is paid for by something else already. If I don't sell another investment product the rest of my life, my lifestyle does not change. Where that's beneficial to you guys if you are my clients is that Joe is truly not emotional about the money. He's not worried about losing a client and losing $5,000 in revenue a year off of you. I'm worried about you losing money and making bad decisions.

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

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

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

MR. CALLAHAN: Sure.

MR. CANARY: I think the last panel we were talking about whether or not the rule should cover life insurance to the extent that life insurance has an investment component. Do you have a view on whether life insurance as a welfare benefit program or welfare benefit should be not covered by the rule even if the life insurance contract has an investment component?

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

MR. CANARY: Okay.

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

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

MR. CALLAHAN: Sure.

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

MR. CALLAHAN: Right.

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

MR. CALLAHAN: It is both.

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

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

MR. CANARY: All right.

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

Again, you can define it certain ways, but in practice if you look at the FINRA regime of using a variable annuity versus the state insurance regime of using a fixed or indexed annuity, the FINRA regime is far more robust, and to build a rule designed to protect consumers and then carve out the least of the regimes as an easier path, I don't understand at the end of the day how that helps the customer.

MR. CANARY: Thank you.

MR. COSBY: Yes.

MS. HALL: Go ahead.

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

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

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

We live off of whatever the commission

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

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

And so that's kind of our basis points compared to a fee-based guy that may be for that same million dollar guy may be making $12,500 or something. I'd soon the consumer keep that $10,000 and not give it to me. Two things. It helps their accounts, helps them pay for college, helps them do whatever, but it helps me to be nonemotional. That's the biggest thing that we run into is the fear of us doing these things as we get emotional about our money.

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

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

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

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

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

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

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

But when you get nervous, I want you to pick the phone up and call me because I'm probably not nervous. I need to know when you're emotionally nervous that you're going to make a bad decision so I can stop you or advise you or help you through the process. And so that's kind of our model.

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

MR. CALLAHAN: Sure.

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

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

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

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

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

MR. CALLAHAN: Sure.

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

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

MR. COSBY: No, I understand. I don't want to argue either.

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

So I'd like to think I'm here to sway the outcome, but I'm not sure that it will, but I do want to be here to be on the record. I want to be on the record saying that what's happening in the U.K., or at least what they're examining, based on our own business model we met offsite a week ago and we've already made a decision if this rule moves forward how we will address it and where we will cut off access in the market to deal with the uncertainty and exposure. And I just want to be on the record to say that in my opinion I'm confident that is what's going to happen.

MR. COSBY: Okay.

MR. HAUSER: Let me just, so we're going to let Joe Canary ask one last question, but, you know, I just want to make completely clear, because I don't want this lost in the shuffle. This is not about brokers versus advisors. We aren't putting a thumb on the scale. Our aim is to permit all of these models to move forward.

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

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

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

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

MR. HAUSER: Terrific.

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

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

MR. HAUSER: You mean FINRA?

MR. CALLAHAN: Correct.

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

So if you could in your supplemental comments talk about whether you have what you think is a contract with your customers, how that's formed, how it works for you. I think would be helpful because we've had people suggest that we need to think about different ways of describing the contractual undertaking, and so I think your experience would be I hope particularly valuable in informing us on that.

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

MR. CANARY: Okay. Thank you.

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

VOICE: Thank you.

MR. HAUSER: Panel 16, I think.

(Pause.)

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

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

My testimony today will cover three primary concerns with the Department's proposal. First, the proposal's definition of recommendation and its elimination of the existing mutual understanding requirement; second, the proposal's effect in the institutional marketplace; and, finally, the proposal's treatment of statements of asset values provided by bank custodians.

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

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

Given the significance of the widespread concerns with the current proposal, we urge the Department to issue a revised proposal and allow for additional public comment prior to issuing a final rule.

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

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

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

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

In fact, the proposal could be interpreted to capture within investment advice virtually any and every investment-related conversation with a participant, beneficiary, plan fiduciary or IRA owner. This could include, for example, sales conversations, requests for proposals, discussion of new products and services, discussions of performance data and other communications that should fall well outside the scope of ERISA's justifiably strict fiduciary responsibility requirements.

Treating every such investment-related conversation or sales pitch as potential fiduciary investment advice will unnecessarily limit a plan fiduciary's ability to obtain and consider information, analysis and viewpoints from multiple sources in making their investment decisions.

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

Indeed, plan fiduciaries and retirement investors often seek investment suggestions, market color and performance data in casual conversations with their bank custodians that neither side expects will rise to the level of fiduciary investment advice. Because of its overly broad definition of investment advice, the current form of the proposal will only serve to cut off or stifle retirement providers' conversations with their retirement customers for fear that any such conversation could be deemed a fiduciary act that could result in a prohibited transaction or self-dealing violation.

Failure to narrow the definition to situations where both parties understand the service provider is making bona fide, individualized investment recommendations that will be relied upon as a primary basis for investment decisions only inhibit retirement customers' ability to obtain and understand investment information. By promoting awkward and truncated investment discussions, the proposal is also likely to reduce customers' trust in their retirement providers' ability to respond to their investment needs and objectives.

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

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

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

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

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

Therefore, we believe the proposal needs to be modified to recognize the differences between unsophisticated retail investors who have limited sources of investment information and institutional or other sophisticated investors. In particular, the proposal should recognize that institutional investors often rely on their own investment experts and are in no way expecting their custodian banks to act as ERISA fiduciaries every time they make a suggestion regarding their products or other investments.

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

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

Under the proposal, investment advice could be interpreted to include such statements if provided in connection with a specific transaction. ABA is concerned that the inclusion of the words similar statement concerning the value of securities or other property, when read together with the associated carve-out, creates confusion with respect to routine reporting that is not legally required, such as periodic reporting of account assets and prices.

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

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

The proposal's carve-out, which exempts statements of value solely provided for compliance with legal reporting and disclosure obligations, is too narrow to afford protection for banks and others who routinely provide statements of values outside legally required reporting and disclosure. We therefore urge the Department to revise the proposal to exclude any statements of value that consist solely of objective financial data.

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

MR. HAUSER: Thank you. Mr. Valenti?

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

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

The stakes for workers and retirees today are far higher than they were four decades ago. When the current so-called suitability standard was established in 1975, nearly three-quarters of all workers in a retirement plan were participants in defined benefit pensions. Today, most Americans' retirement savings lie instead in vehicles such as 401(k) plans and individual retirement accounts or IRAs.

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

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

Consequently, it's important that families can turn to financial professionals to help them chart a course for retirement. However, such professionals are only a benefit to families if they provide the best advice for the saver rather than for their own earnings. In other words, this advice must meet the highest standard for a relationship of trust, a fiduciary standard.

Unfortunately, the current suitability standard, which is four decades old, reflects a lower standard of care. It ignores the significant

long-term consequences of even one-time advice and enables contracts to imply in fine print that these are not binding relationships of trust. As a result, broker dealers and others are able to market themselves as financial advisors or consultants without actually complying with the rules that normally govern such relationships.

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

The market for IRAs is a prime example. Today the $7.4 trillion in IRA assets even exceed those in 401(k) plans. The vast majority of these funds come from rollovers when workers change jobs or retire. As the Government Accountability Office recently found, workers leaving a job who sought advice were often highly encouraged to convert to a high cost IRA even if they could stay in their plan or move their savings to their new employer's plan.

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

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

What's more, conflicted advice often carries significant consequences beyond excessive investment and plan management fees. Consider Elaine and Merlin Toffel of Illinois, whose story was reported last year in the New York Times. After meeting with brokers at their trusted local bank branch, they sold a portfolio of low-cost investments, incurring tax consequences along the way, and invested most of their money in expensive variable annuities recommended by the bank with a 4 percent annual fee and a 7 percent surrender charge for accessing funds early.

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

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

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

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

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

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

Some have also speculated that enhanced disclosures alone could address this need. Notably, the proposed best interest contract exemption contains several key disclosures that could potentially empower consumers to identify fees in a clear and comprehensible manner. CAP strongly supports prepurchase disclosures that illustrate the effects of fees not just in one year, but also the consequences of compounding over a 20-year period.

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

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

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

MR. HAUSER: Thank you.

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

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

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

Retirement savings is a social and national imperative. The positive externalities of adequate retirement savings are immense. In the U.S., total household savings is under 4 percent and projected to fall further, particularly due to low saving rates among young workers. In 2012, the average U.S. worker spent more on coffee than they invested for retirement. We are a consumer culture.

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

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

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

The Department appears to acknowledge this by proposing a seller's carve-out for plans greater than a hundred participants. However, I believe there's a more straightforward approach. My first recommendation is that you modify the proposed rule such that by definition it only applies to persons directly advising individual accounts or small plans. This would avoid introducing unnecessary ambiguity, risk and cost on the institutional market.

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

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

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

My third recommendation is that the Department accelerate work to enable state and open multiple employer plans, MEPs, to move forward. This will significantly benefit small savers, which is a segment of the market that deserves the most attention and is the most at risk of being further underserved. While this segment could be helped through technology or other means, our collective efforts would fall short of truly helping them improve their financial security if we commoditize them in the same way that the advice to them is increasingly proposed to be commoditized.

As the Department notes in its analysis, many retirement accounts are either in an employer sponsored plan or the result of a rollover from an employer plan. Employers provide these plans as a competitive means of retracting and retaining employees. Larger employers have the expertise in-house to set up such a plan or, in any event, are able to afford the cost of outsourcing that work. Smaller plans do not have these scale advantages.

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

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

My fourth recommendation is to piggyback off those efforts and facilitate the emergence of private or open MEPs. To the extent that changes in the proposed rules may cause small savers to be underserved, allowing these plans to organize under an MEP structure would not only mitigate that impact; it would also vastly improve their ability to deliver higher quality, lower cost solutions to their employees. It would further increase the propensity of small employers to set up retirement plans, which by itself would be a significant contribution to improving national retirement security.

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

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

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

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

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

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

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

There are also situations where passive management may not be in the best interest of clients. For example, passive strategies are not clearly defined. Russell calculates over 700,000 benchmarks daily. Any one of these could be a passive strategy. Passive strategies still require active intervention for allocation among passive choices.

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

Investment solutions should be designed to seek the optimal risk/return tradeoff to help investors improve their financial security and should use the full spectrum of tools available without comps (phonetic), not just costs in mind. Passive and smart beta are highly useful tools to be wielded in that process, but they are not a substitute for a well diversified and appropriately constructed and managed portfolio.

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

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

We have seen this play out in the DC space all too often despite our best efforts to highlight the need for sponsors to follow a robust, prudent process through which process they decide the balance of risk, return and cost that is best suited for their needs, which invariably will include some, but not exclusively, passive strategies.

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

MR. HAUSER: Thank you.

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

The rule as currently drafted requires that there be a recommendation directly to the plan, plan fiduciary, participant, beneficiary, IRA or IRA owner. Am I correct in understanding that your concern is on the reference to plan fiduciary there in terms of the institutional space because it would seem like if you're dealing with advice to an institutional investor you're not normally dealing with a plan unless you're treating an institutional investor as a large plan or the individual participant, the beneficiary or IRA? Is that the textual focus of your concern?

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

MR. CANARY: Okay.

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

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

That's where my suggestion very basically would be flip it on its head and rather than creating a carve-out limit the scope of the rule to those, the inverse of who you would have carved out, so the retail.

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

MR. LARSON: Okay.

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

MR. LARSON: Yes. From our experience, yes, that's primarily, but I guess I'm saying they can

co-exist.

MR. CANARY: Okay.

MR. LARSON: The existing standards that have existed for institutional plans, the judicial precedent, everything that's out there, I wouldn't want to see it all disrupted and create additional ambiguity trying to figure out how that now plays under a new standard with new rules because, as I said, I think it works and you've already got the safeguards and protections in place.

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

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

MR. CANARY: Okay. So let me follow up on that for a second. How do you distinguish between an institutional investor versus other sophisticated investors because we have seen in the securities laws accredited investor test, and the dollar threshold there seems like it could actually capture a fair percentage of a rollover market where I think the investor might perceive themselves to be more of a retail investor rather than a sophisticated investor if it's measured just based on the account size. What would your test be?

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

MR. CANARY: I see.

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

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

I think as a general matter though, there should be a fiduciary and those should be exceptions. My institutional comment was just that I think the two are very different, and particularly because of the history on the institutional side I think that's why I would treat those very separately versus on the rest of the market, if you will. I think it's fine to have a uniform standard and then carve out as need be.

MR. CANARY: Okay.

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

MR. CANARY: Sure.

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

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

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

MR. CLEARY: Yes, similar to the concept under the FINRA rule that there's an express acknowledgement from the advice recipient that they're making their own independent decisions.

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

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

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

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

So I think we need to get it right first in terms of who is an investment advice fiduciary in the first place, so I think that's important regardless of the institutional retail distinction, and then secondly I think once you are a fiduciary, yes, there should be a carve-out for institutional investors even if you fit within that tailored --

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

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

MR. CLEARY: I think there should be the ability with both parties agreeing, the sophisticated investor and the advice provider, to make that arrangement themselves and to agree on those parameters of the relationship on their own, yes.

MR. CANARY: Mr. Larson?

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

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

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

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

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

MR. CANARY: Sure.

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

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

MR. CANARY: All right. Thank you. Let me follow up with you on a different subject. I think you have echoed something we've heard from other witnesses about concern with the mandatory arbitration provision that is in the best interest contract exemption, and some people have sort of elaborated on the reason why they have that concern. Could you give us a little bit more of your thoughts on that?

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

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

Conversively, what the Consumer Financial Protection Bureau found in its review of arbitration agreements, again looking at the credit card market, which is perhaps a little bit different than retirement security, the issuers with arbitration clauses and the issuers without them did not have statistically significant differences in fees, so it was not a scenario in which the presence of arbitration actually resulted in lower fees for consumers.

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

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

I would think a more serious example might be 529 plans; that there is fairly significant debate even among financial experts about saving for college versus saving for retirement. Clearly there are different structures in 529s, and I would not want to see overconcentration in 529 plans as opposed to 401(k)s and IRAs as a result of prohibitions on conflicted advice.

MR. CANARY: Thank you.

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

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

And I'm equally concerned that under a mutual agreement kind of test you could actually have a circumstance where both parties really thought that this was a relationship of reliance, but again by virtue of a contractual disclaimer, you know, there's no longer fiduciary status. Although our guidance is provided one-to-one, you know, on a professional basis, it is not to be relied upon as a primary basis for your investment decision making or your tax planning.

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

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

At the retail level I think that the easiest solution to that type of confusion is a prominent and clear disclosure up front that the advisor is not intending to offer investment advice. I also think that the limitations on the content of what would be outside the fiduciary context would be helpful along the lines of the FINRA guidance where there are specific examples of asset allocation models, general investment advice and the like and also more generally directed communications that do not constitute a recommendation. I think that type of guidance could help put some parameters around that along with the --

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

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

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

MR. CLEARY: I think again that you're correct. I agree. A balance needs to be struck there, and I do think regardless of the disclaimer there could be some conduct that would cross that line and a disclaimer -- it would have to be the combination of staying within certain parameters and an appropriate disclosure.

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

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

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

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

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

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

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

I think if that type of distinction were more clear and the line were brighter between a suggestion, a specifically directed suggestion, I think what an objective person would consider a suggestion is too vague.

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

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

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

Disclosures, disclaimers, they don't work for investors. Most people, once they have their expectations set of what they're getting and what they're doing that's the framework in which they operate. I think looking at the review, the output from the RDR analysis that came out of the U.K., the same thing.

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

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

If you look at the person who's skeptical and maybe doesn't want to be in an advised relationship and is doing it themselves, cost goes up, but even not that high still so I think even for them, you know, how important is the disclosure around cost? I think it's moderately important, but they're coming at it from a different frame of mind.

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

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

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

So I think those are some of the things that I think are really important. From what it sounds like you're on the right track and we'd support where you're headed, but with some of those cautions I guess peppered in there.

MR. HAUSER: Thank you.

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

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

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

To the extent that you are able to shine a light on both the direct costs and the hidden costs, including both investment management fees and administrative fees, particularly in simple dollar terms, you are able to educate investors, and as Morningstar and other firms have found in their research low-cost funds have often outperformed

high-cost funds, so cost is a significant consideration for consumers even if they're not aware of it at the time.

MR. HAUSER: Thank you.

MR. LARSON: May I add something to that?

MR. HAUSER: Sure.

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

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

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

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

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

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

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

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

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

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

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

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

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

MR. HAUSER: Well, that's correct. If there's no recommendation you don't get to it and so maybe carve-out was the wrong word to use. But can I just say --

MR. CLEARY: Sure.

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

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

And if you're really careful you could answer that question factually, but my concern is that the investor will say well, they suggested that I go into that fund, and you can get into a real debate about objectively would that have been a suggestion or not, and I just think that shouldn't even be.

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

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

(Pause.)

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

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

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

Supovitz Consulting Group in Worcester, Massachusetts. We provide consulting, administrative, actuarial and investment advisory services to employer sponsored retirement plans.

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

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

But we do see some disconnects in the proposed rule that we think would undermine our ability to serve clients in the best way possible. It's our hope and actually our very strong belief that we can get to a rule that's more workable and more beneficial for the people that it's designed to help. So to that end my testimony today will focus on five key concerns, and the first relates to rollovers in connection with the workplace retirement plans that we serve.

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

So we know that any increase in compensation here would be a prohibited transaction unless an exemption applies and, as I'll talk about in a minute, it isn't clear that any such exemption exists. So first let me give you a specific example of why this rollover concern is very important. Suppose we have a 401(k) participant. I'm going to call him Joe has been working with Plan Advisor A for over 10 years and, like many working Americans, the only advisor Joe works with is Advisor A through his 401(k) plan at work.

So now Joe is about to retire, and the plan doesn't offer systematic withdrawals, which is very, very common. In fact, my understanding is that it applies to your own TSP plan for government employees. So the plan doesn't offer systematic withdrawals, and as a result Joe wants to work with Advisor A on a rollover because he trusts her and because the plan doesn't give him an effective way to manage his money in retirement.

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

Now, it isn't clear that the best interest contract exemption -- I'm going to call it the BICE. It isn't clear the BICE is available for rollover transactions to begin with, but even if it is it still wouldn't be available for this rollover transaction because it doesn't extend to discretionary investment management.

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

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

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

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

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

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

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

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

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

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

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

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

MR. CANARY: Thank you.

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

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

The proposal and the related exemptions will affect virtually every aspect of SPARK members' retirement business. Our comment letter and my testimony focus primarily on how the proposal will affect our members' ability to continue providing their invaluable education, guidance and services to both plan sponsors and their participants.

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

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

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

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

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

A fundamental concern that SPARK members have with the proposal is that it calls into question a variety of communications that service providers have with participants that cannot reasonably be viewed as investment advice. Participants generally receive two kinds of communication from plan sponsors and their service providers. First, generic plan related information, much of which is required by law. For example, this would include the summary plan description.

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

Many service provider communications therefore are suggestions that participants either take an action, like diversifying their account, or not take an action, like avoiding taking a loan or early distribution. Our comment letter makes a number of suggestions to help the proposal's definition of fiduciary investment advice better focus on those recommendations that a reasonable person would expect to be fiduciary in nature.

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

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

This letter provides a list of all the target date funds options available to the participant and explains why target date funds may be an appropriate way for a participant to diversify their account. This communication appears specifically directed to a participant, but no one would think of that as fiduciary investment advice.

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

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

Finally, we ask the Department to confirm longstanding guidance that a fiduciary may limit the scope and timeframe of the fiduciary's duties and obligations. We offer a number of suggestions for clarification on this matter, and you'll find them on page 16 and 17 of our letter.

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

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

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

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

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

Instead, the carve-outs should be available if the service provider identifies investment is based on objective criteria, it is disclosed to the advice recipient. The selection and monitoring carve-outs should also allow service providers to furnish a sample menu and provide mapping assistance if accompanied by appropriate disclosure.

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

The most effective way to enable providers to continue to provide their crucial services while still protecting plans and retirement savers will be to narrow the proposal's definition of what constitutes investment advice and better accommodate existing education tools within those proposed

carve-outs.

Again, my final comments are on the proposed effective dates. The entire regulated community will need a substantial amount of time to implement these new rules. We urge the Department to consider 36 months for compliance. An insufficient timeline would force providers to immediately halt longstanding services. The retirement industry has focused on this fiduciary definition for over 40 years, and it cannot be undone in eight months.

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

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

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

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

MR. ROUSE: No. That's fine. Any time that a recommendation is made, I mean, we I think are a hundred percent in agreement with you that any time an investment recommendation is made that you've crossed the line into a fiduciary role. We're comfortable with that. I think where we and our members are looking for help is identifying that line more clearly.

MR. CANARY: Okay. So I think the word individualize is being used and personalized, so help me a little bit with what you think that line should be where the fact pattern that I've described, which I think would be covered under our proposal, would also be covered under the way you would define the recommendation component of our proposal.

MR. HADLEY: I would just add that individualized probably doesn't. If it's individualized you've already got that in your rule. You don't need specifically directed --

MR. CANARY: So you don't think individualized requires that they actually have an understanding of the needs or circumstances of the person to whom they're providing that recommendation?

MR. HADLEY: That's a different question from whether or not something that's specifically directed triggers fiduciary status, and that's really what we're really concerned about is that.

MR. CANARY: Okay.

MR. HADLEY: The way you defined it if it's not individualized, but it is specifically directed, it looks like it's covered and we don't think you mean that.

MR. CANARY: Yeah. Maybe we should get your input on it. I'm still not entirely clear on where you think something is, then individualized if, for example, I'm making a recommendation to everybody in this room, you should all do the following investment action and I don't know any of these people, but I'm directing them specifically to you in an environment where it would be perceived by them as a recommendation, as a call to action.

But I guess are we in agreement that you all think that as long as it's specifically directed to an individual, be perceived to them as a call to action to make a particular investment, that that should be covered by the rule regardless of the term that you use for it?

MR. ROUSE: Yes. Whenever there's a call to action for a direct investment decision then I think we do basically agree --

MR. CANARY: Okay.

MR. ROUSE: -- that you cross the line into a fiduciary role.

MR. CANARY: And it wouldn't be a defense to then say I really didn't know about your individual circumstances, so therefore it couldn't possibly be investment advice covered by the rule. That would not in your view be a defense or should be available as a defense to fiduciary status?

MR. ROUSE: Correct.

MR. CANARY: Okay.

MS. SUPOVITZ: We would agree with that.

MR. CANARY: Okay. Thank you. The

carve-out language, I think we've talked about this before in terms of just the terminology. I think Mr. Hauser has said maybe we could have done a little bit better in terms of our terminology. Let me explore that a little bit with you and then maybe get your thoughts on what would be a better way to describe what we've done.

If you look at the proposal, we carve out, we use limitation when we're describing these provisions. We also use text. It didn't actually use a word to try to describe what we're trying to accomplish. Some of the provisions that we designated in the carve-outs, if you comply with them, don't involve a recommendation so I feel like the education provision, you said that doesn't involve a recommendation.

So a carve-out may not be the right term for what that provision is, but others would actually involve conduct that would amount to a recommendation if you look at the seller's carve-out and say that envisioned circumstances where you could be making a communication or recommendation that otherwise would fit within the scope of the rule.

So if you're thinking about the way we should describe these provisions we were trying to capture, although with certainty people have asked for where they've said we want to be clear that education is not covered, but we're also dealing with certain conduct like the seller's provision where it actually could be covered by the general definition.

How would you have us describe that in a way that would reduce some of the I think confusion that people have said they have looking at the term

carve-out?

MR. ROUSE: And we've appreciated over this morning and over the past few days your willingness to kind of go back to some of that language and help clarify that. We're very grateful that you've done that. I don't know if we can add much more than what the other witnesses have told you before. Mike, do you have anything?

MR. HADLEY: I mean, with education we're not trying to use education to get a recommendation in disguise. We're just trying to clarify circumstances where, back to the general principle, a reasonable person would not think that they are getting fiduciary advice and clarify that in the context of education.

In the seller's carve-out our point really is that a small business owner can understand, just like a large business owner, that the person is a vendor, and we expect fiduciaries, all fiduciaries, to be able to have at least that amount of knowledge.

MR. ROUSE: And one other thing that I'd like to add to the small business aspect of it is today small businessmen have two channels in which they can buy this product. They can buy it through a benefits broker or they can buy it directly from a service provider.

With the way the provision is written today, that channel, that direct channel would no longer be really available to them. The likelihood is that that channel would dry up. And in many regards that may be the best channel for them, and I don't think it's your intention to close off that channel because, like I said, it may be the better solution for a plan sponsor to buy it directly, but many plan service providers would naturally close that off rather than becoming a fiduciary on the plan.

MS. SUPOVITZ: In response to your question regarding the terminology of a carve-out, first I want to just add that another scenario, just like what you're describing, relates to the platform provider carve-out, which I guess you really have to question up front if you're offering a platform is that advice at all that even requires a carve-out.

So I think the way that we would view it is simply that certain things just aren't considered advice, but if things are considered advice then certain things are carved out from the fiduciary definition.

MR. CANARY: So let me follow up on the platform providers. Compare for me as you're looking at it platform provider and the seller's provision. At one level the notion of the platform provider was potentially a variant of a seller's carve-out for a particular type of activity, the platform provider and the assistance and the selection and the monitoring of investment options that would be available in a plan.

So if we adjusted the platform provider provision as you've recommended, what other sorts of sales activity in the small employer marketplace is then necessary to be covered by an expanded seller's exception?

MR. ROUSE: Ultimately when you're selling the plan to that small plan provider, and if it is direct that there comes that moment in which you now have to take this universe of thousands of funds and decide which funds are now going to be part of that plan.

And many of the service providers today utilize a third party service or some other independent to allow them to do that, but based on what the regulations say in terms of recommending an investment provider that would cause the service provider to be a fiduciary, and it's our opinion that that shouldn't be the case and if it wasn't then we could then offer that service provider's recommendations and monitoring for the funds to narrow the universe down to the reasonable number that you want to offer in your plan.

MR. CANARY: Right. So assume that the platform provider and selection and monitoring provisions are just in the way that you think would cover that activity. What else is necessary for the small employer and the seller's provision? One of the concerns is the seller's provision is very open-ended.

MR. ROUSE: Yeah.

MR. CANARY: It doesn't really have a limitation on the type of recommendation that would be involved except for a very broad introductory section, which I know people have some questions about that scope, but it's much broader than the platform provider provision.

So if we change the platform provider provision the way that you're recommending, do you need small employers to be in the seller's exception, and if you do what activity are you covering that's necessary?

MR. ROUSE: I think that would be a major step forward and would make us much more comfortable with the small business plan provisions of the regulations.

MR. CANARY: All right. Thank you.

MS. SUPOVITZ: Yeah. I do want to point out that the language the way it's written for the platform provider exception it's not entirely clear to us that it's available to other than the provider, and very often there are intermediaries who are actually the ones marketing those platforms and they can be third party administrators. They could be advisors. They can be others.

And we don't think it was the Department's intent to suggest that those intermediaries that market those platforms shouldn't have the same

carve-out, so assuming that that language is the way we're hoping it will be corrected to be then I think that goes a long way in answer to your question.

MR. CANARY: Thank you. Switching subjects, there's been a fair amount of discussion about the arbitration provision in the best interest contract exemption. Do you all share the views, either one side or the other, about the arbitration provision, whether it's a fatal flaw as some have described versus something that would be helpful?

MR. ROUSE: It's not come up as a primary discussion item of all the other items that we've had. But, Mike, I don't know if it's come up in --

MR. HADLEY: We haven't talked to the members about it. We have to talk to them.

MR. CANARY: Okay.

MR. VALENTI: Nor have we focused on that particular point.

MR. CANARY: Okay. The platform issue again in a different context. I think there's a suggestion in the comments that the platform provider provision be expanded to the IRA market.

Can you talk to me a little bit about what you're envisioning as a platform in the IRA market that would fit that provision and your thoughts about the difference between the ERISA space where there is an intervening fiduciary responsible for making a prudent selection of the investments that are available in that platform before they're made available to the participants and beneficiaries versus the IRA space where you don't have that kind of intervening fiduciary?

MS. SUPOVITZ: What we would suggest is that the platform provider carve out, allow for IRA platforms that meet one of three criteria. Either it's an open architecture platform, that it's pretty much record keeping for any say mutual fund out there, or it's a platform that doesn't offer any proprietary investments or it offers only investments that have been blessed by an independent third party fiduciary, and in a scenario like that we would recommend that the platform provider exception be extended to IRAs.

MR. CANARY: Okay.

MR. ROUSE: We would agree that any recommendation on a specific investment again becomes fiduciary, but as long as we remain within the factual context of what the plan allows that our providers and our representatives are able to talk about the distribution options that are available the moment that, you know, we got into them.

Whether it's an open architecture or whatever platform, that becomes a different conversation and we're not limiting our service reps from any education that's necessary for participants.

MR. CANARY: Okay. So on the three areas you talked about, the open architecture, I gather that since the person can invest in anything that's available there isn't implicit in that a recommendation as to what to invest in.

MS. SUPOVITZ: Correct.

MR. CANARY: And in the independent fiduciary determination you end up saying we have at least in the ERISA space that it would be adopted

over at the IRA space some intervening judgment being made about the appropriateness of that investment option taking into account fees, potential conflicts, et cetera.

MS. SUPOVITZ: Correct.

MR. CANARY: But in the nonproprietary space is there still a possibility that the person constructing that platform is going to have a financial interest in what's on the platform where you may have a limited range where there could be an implicit recommendation and a financial interest that no independent party has evaluated?

MS. SUPOVITZ: Well, thinking about that off the cuff, certainly you would want a levelized compensation structure there.

MR. CANARY: Okay.

MS. SUPOVITZ: And that's the way we would envision it being designed; that it would basically be a wrap fee for the recordkeeping services.

MR. CANARY: Okay. I have more, but so that Tim doesn't say I'm doing the same thing he was doing maybe I'll turn it over and see if any of my colleagues would like to ask some questions.

MR. COSBY: Okay. I have a question focused on the small business owners. You both indicated your concern about advice to them being cut off because compensation models that advisors would receive would be affected by the rule and so there would be a prohibited transaction. I was just wondering if you could expand on that a little bit so I could understand exactly what you're referring to.

MS. SUPOVITZ: Uh-huh. So in a level compensation environment, pretty simple. The advisor is typically going to charge, you know, certain basis points on assets in the plan. In the small plan market I guess the best example to look at is a start up plan, which of course is where we really need to and want to expand coverage. If you have a start up plan there are no assets in the plan.

So today there are compensation models on the commission side where the compensation is still level across all the investments offered in the plan, but it's actually commissions paid by the provider because there are no assets yet. They're fronting those commissions.

Under the proposal as written that would need to use the best interest contract exemption, but that exemption isn't available at the plan level to participant directed DC plans. So do you just tell all of these advisors that are helping to build coverage in that small plan market either do it for free or wait a long time before you're ever going to get paid? It just doesn't work. So that's the main reason we need to extend that BICE to that marketplace that's excluded right now.

MR. COSBY: And if it were extended to them they'd be receptive to the exemption and those conditions?

MS. SUPOVITZ: Well, I think there are a lot of other issues we'd want to tweak with the exemption, but, you know, assuming the exemption gets to a point that it's workable then absolutely we would want to make that work.

MR. COSBY: And then still on the subject of small businesses, so right now the counterparty

carve-out doesn't include small businesses, and the definition is, you know, the hundred participant definition that we've always used. I was just wondering. Do you think it should be open to plans of all sizes, or would there be any type of cutoff at all that would be appropriate?

Because I guess the concern is that literature has shown that small business owners have some of the same issues that individual investors have with respect to actually understanding the capacity that the investment advisor has provided them advice under and other similar issues, so I was just curious about do you think it should be open regardless of size, or is there any size limitation that would be appropriate?

MS. SUPOVITZ: We support the best interest standard and so when it comes to that particular area, I mean, from our point of view we don't necessarily have a problem the way it sits.

MR. COSBY: And I just had a question, Mr.

Rouse. You had talked about you were looking at the platform carve-out, and you were talking about like mapping assistance and other type of assistance.

I was just trying to understand more about that because it sounded like you were explaining that more or less outside of the exception, so I was just wondering what exactly you were referring to when you were talking about that type of activity.

MR. ROUSE: So many small plans at some point in the discussion after you've discussed your fees, after you've discussed your services and after a plan sponsor is likely to move over then there comes that moment in time, that critical moment, where it now becomes an issue of which funds do I want to include in my plan.

Many service providers, rather than giving advice, will utilize an outside third party to do that for that plan sponsor and allow them the ability to then narrow down the scope of thousands or tens of thousands of funds down into a number of workable funds that are available that should be made available to the participants. Does that answer your question?

MR. COSBY: Yeah. I was just wondering if the activity could be done within the platform exception. I guess that's what I was trying to reconcile is, you know, where that's actually fitting.

MR. ROUSE: It's often an arrangement with the service provider and an outside service, and that's typically the way we've seen it.

MR. TAYLOR: And you think it would be a problem for the outside service to be considered a fiduciary or --

MR. ROUSE: No. They take that responsibility.

MR. TAYLOR: Okay. Okay.

MR. ROUSE: No. In here if a service provider is recommending them --

MR. TAYLOR: Uh-huh.

MR. ROUSE: -- the service provider doesn't want to become the fiduciary.

MR. TAYLOR: I understand. Okay.

MR. HADLEY: If I could just add to that? So, you know, the platform, there are sort of two platform carve-outs, one for the platform itself and one for selection and monitoring. You're trying to sort of say you can help with analytics. That's not advice.

And the point is there are a couple things that are like that. One is a sample menu, which is often requested by particularly large plan fiduciaries. We need to see your pricing. Give us a sample. It's presented as a sample with appropriate disclosures. That seems to fit under the platform.

And then the other is okay, we're going to choose you. Can you give us some examples of funds that might map? We'll make our own decision, but give us some that you might have that could fit.

MR. TAYLOR: Just sort of objective information about the funds?

MR. HADLEY: Just objective information, not suggesting a recommendation. That seems similar to kind of applying a screen --

MR. TAYLOR: Uh-huh.

MR. HADLEY: -- of objective criteria.

MR. CANARY: Okay. So let me explore that just a little bit further because under the selection and monitoring provision it does allow for the importer to say here's the general characteristics that I want the funds to meet. What do you have that fits those characteristics? Are you suggesting that something more than that is necessary?

MR. HADLEY: Well, I think we're just looking for clarification that what I just described works.

MR. CANARY: Okay.

MR. HADLEY: And just to add, so, you know, sometimes a service provider is asked can you give us some criteria or might provide a sample investment policy statement, again not representing that as a recommendation to do it, but here are some criteria that we might screen for you if you'd like, and if you want us to do it go ahead. You can choose something else. And again, the language sort of suggests that the employer, the plan sponsor, the fiduciary has got to say here are the ones I want.

MR. CANARY: Uh-huh.

MR. HADLEY: Our view is they're really just approving. They have to have a say, but the service provider could suggest some and the fiduciary approves it.

MR. CANARY: Thank you. Okay. A couple more. There was a question which has been described in different conversations as the hire me issue, whether or not a conversation or a response from RFP or a conversation where you're suggesting that someone engage you is fiduciary investment advice because of the provision in the rule that would cover recommendations of a person to provide investment advice for a fee. So not wanting to get into that specifically, but one element of it.

What are your thoughts on affiliates or related parties where it's not so much hire me, but it's hire an affiliate, a subsidiary, a related party? Should that also be excluded? And if it isn't to be totally excluded is there a need to have some clarity there that the person is an affiliate, that the person would have to understand that the nature of that recommendation is similar to hire me? It's hire my affiliate. Any thoughts on that?

MR. ROUSE: Well, going back to the other example that we talked about earlier of using a third party advisor, as long as it's a third party and the service provider is offering it as a service to help the plan sponsor, I don't think it should fall within the area of fiduciary.

If, on the other hand, you're recommending that you then go to a true affiliate of the organization and it's a recommendation for an investment, I think we agree that any recommendation for an investment is a fiduciary.

MR. CANARY: Okay. Let me -- I'm sorry.

MS. SUPOVITZ: No. That's fine. I just want to make sure I understand the question. So you were talking about if you put language into the rule that allows hire me type scenarios should it also incorporate hire my affiliate?

MR. CANARY: You should be over here asking the questions. I think that was a fair summary.

MS. SUPOVITZ: That was your question?

MR. CANARY: Yes.

MS. SUPOVITZ: Okay. And we would say yes.

MR. CANARY: Okay.

MS. SUPOVITZ: Yes.

MR. CANARY: Let me get a little bit further into that because I think one of the comments also was that that provision should only reach a circumstance where the person is hired specifically to make a recommendation of another person to provide investment advice and is getting paid for that.

So let's again go to this affiliate circumstance and assume that I'm making a recommendation and I was really engaged to do that, but I am going to get a finder's fee or some sort of compensation from the affiliate for every person that engages them.

How do you think about that in connection with a suggested limitation that this provision should only apply in circumstances where I was specifically engaged for a fee to provide this recommendation?

MR. ROUSE: I think our comments we agree that if you were engaged for a fee then --

MR. CANARY: But here there wasn't an understanding of any fee. The finder's fee would be third party compensation that the person receiving the recommendation may not know about.

MS. SUPOVITZ: I would say if you receive a fee that's a direct result of having made that recommendation that kind of solves both sides. So you weren't necessarily engaged, but it's not that you're receiving fees for some other service that had nothing to do with that recommendation.

MR. CANARY: So maybe it's not dependent upon whether I know that you're -- I'm not hiring you necessarily to pay you a fee, but to the extent that you are getting a fee for it --

MS. SUPOVITZ: To the extent you're getting a fee from anywhere, yes.

MR. CANARY: Okay. I'm still not thinking that's quite where SPARK was on this issue.

MR. HADLEY: I mean, our concern is kind of package of services, right? So you offer a package of services. You're not trying to do anything other than sell them. And one part of that package might be access to an advice provider and, you know, our view is if you recommend another fiduciary that fiduciary is going to have fiduciary obligations.

And the rule talked about investment advice. It has traditionally been interpreted to include kind of investment management. What we think you're worried about are consultants who are hired to provide advice by investment managers do so and get a fee for that.

That seems to be your concern, not -- I don't think -- sort of these package of services or a scenario where somebody comes and says, we have, you know, we'd like to make available investment professionals and there's a slate of people that you sort of have relationships with and you can say here's who we have make available to third parties, that that should be considered to be investment advice.

MR. CANARY: Okay. I think this is really just a SPARK comment, and if I'm reading it correctly your comments departed pretty significantly from I think the stream of comments we're getting on adopting the FINRA standards for what would constitute a recommendation.

If I read your comment correctly you're saying we should not do that. We should not adopt the FINRA standards in defining what would constitute a recommendation under our rule.

MR. ROUSE: I think we think that they don't specifically apply in the same way for these retirement plans and that there's a reasonableness standard that needs to be implemented here.

MR. CANARY: Okay. Help me a little bit more because I think what we've heard from other sources is people believe that there's an established sort of body of information and practices that have developed around the FINRA distinction between what's education, what's your recommendation, what's sales, what's your recommendation.

And if we don't use that kind of body to help inform our definition of recommendation, which I think our preamble specifically asked whether we should be adopting some or all of the FINRA standards, and we just went with a reasonableness standard I'm thinking we're going to end up with a lot of the other commenters finding that inadequate.

MR. HADLEY: I guess I would just sort of respond to what the members seem to be concerned about.

MR. CANARY: Okay.

MR. HADLEY: They seem to be concerned, one, that that standard was developed for a very different set of circumstances. It was developed for a different regulatory structure, as you guys would point out. It's two different regulatory structures.

And then second, some folks express concern that if you sort of incorporate by reference then FINRA changes something. Does that mean it gets changed here? What's the relationship? I mean, fundamentally we agree that it needs to be an individualized recommendation, but the test has to be sort of designed for the circumstances under which advice is given in the retirement space and the implication being fiduciary status, which is very different than under FINRA rules.

MR. CANARY: Okay. So let me make sure I've got that. To the extent that the FINRA provisions are directed at some investment recommendations and you're talking about an area where it's not so much an investment recommendation per se, but it's a service recommendation or it's a platform, that there's some question in your mind as to whether the terminology that FINRA used is going to be able to translated over into things that may not be investment specific kind of recommendations.

MR. HADLEY: You should be on this side. I think you've got it.

MR. CANARY: All right. Thank you. Then I don't know. I have one more, but if --

MR. COSBY: Go ahead.

MR. CANARY: Okay. I don't think we've really talked about it too much, and it may be different in your space than it would be, for example, where we're dealing with a broker because I'm thinking that's not primarily what you're focused on is brokerage services.

The best interest contract provision has a contract requirement in it. To the extent that you were in need of relying upon the best interest contract exemption, do you have any concerns about the existence of a contract requirement in terms of the way your business models were structured?

MR. ROUSE: Yes, and I think that as we mentioned it's somewhat unworkable. And we used the example again of the small business. It would essentially close down a direct channel for small businesses, so a small businessman would not go to a service provider. At least if it did they would be told we're not going to act as a fiduciary and then force them to go through a broker sold channel. So there's, that's the concern that --

MR. CANARY: Okay. So just let me follow up on that just a little bit. This may also be one of these scope issues. To the extent that you're really talking about the activity that let's assume would be covered by a platform provider and selection and monitoring provision as you would design it --

MR. ROUSE: Uh-huh.

MR. CANARY: -- then do you have issues with other activities for which you might need a best interest contract exemption where a contract requirement would apply?

MR. ROUSE: No. I think we addressed that earlier that if you have the ability to ultimately use a third party and have the platform exemption that that would address the big concern there.

MR. CANARY: Okay.

MS. SUPOVITZ: Well, certainly there would be scenarios it would apply to with what I just spoke about with small plans. If we allow those small, participant directed, noncontribution plans as part of the BICE, assuming that happens, then that contract provision would apply and at least off the cuff, and I haven't discussed it with all our members, I would assume they would have no problem with that.

MR. CANARY: Okay. All right. Any of my colleagues?

MR. TAYLOR: Lyssa?

MS. HALL: No.

MR. TAYLOR: I'd just like to ask a question or two about rollovers. I noticed, Ms. Supovitz, that you talked about that some in your own comment letter and you suggested this level-to-level alternative exemption.

I'd just like a better sense of if it was clear that the best interest contract applied to rollovers do you think that would be working or do you think that they really need a separate exemption to handle the rollovers?

MS. SUPOVITZ: Yeah. We believe that it really should be a separate exemption for a couple of reasons. So the best interest contract exemption, as you know, was designed for differential comp and so most of the provisions are aimed toward that and we don't have that scenario here.

Secondly, the best interest contract exemption doesn't allow for discretionary management, and of course you wouldn't want it to allow for discretionary management because if your comp is variable you could through your own discretion keep increasing your comp, so you wouldn't want to mix those two together.

In the scenarios that I'm describing

compensation is level, and very often -- most often -- it's a discretionary account that's being managed, so for those reasons we really think it should be a separate, streamlined, simple exemption.

MR. TAYLOR: Okay. And you think that, talk about it being level-to-level, but I just want to make sure I understand. There is a move from one level to another when you do the rollover --

MS. SUPOVITZ: Correct.

MR. TAYLOR: -- obviously and so you don't believe that the same protections are necessary that we would have in the best interest just to go from that to deal with that?

I mean, I see billboards when I'm driving sometimes about people, you know, saying come and speak to me about taking your money out of the plan and putting it into an IRA.

MS. SUPOVITZ: Yes. I see them. I see them as well.

MR. TAYLOR: There's a lot of --

MS. SUPOVITZ: Yes.

MR. TAYLOR: -- sales activity out there.

MS. SUPOVITZ: Yes. And we care a lot about that issue because, you know, we're definitely very strongly in favor of the best interest standard. Here we're talking about a scenario where it's strictly fee for service. It's completely investment neutral on both sides. The only question is should this person really roll over and what do they want from their IRA.

So if they say, you know, I really want somebody to develop a retirement income program for me and manage that for me and take into account everything that goes into that, that would always be at a different fee than the plan. We are suggesting that you document the reason it was in the person's best interest to roll into their own IRA.

Usually it's because plans don't allow systematic withdrawals or it might be because they simply don't want to leave their money with a prior employer. Once in a while it might be because they want investments that aren't offered in the plan. I mean, there are a variety of very valid reasons, and we just want to make sure that the kinds of advisors that this whole rule is intending to promote aren't left out of that equation.

MR. TAYLOR: All right. Now on the education advice -- do we have time yet?

MR. CANARY: You've got like one minute.

MR. TAYLOR: Okay. Just briefly, you talked about having --

MR. CANARY: Actually you don't have a minute, but go ahead. Go ahead

MR. TAYLOR: Okay. Fine. It's just on the education advice you mentioned that in many cases the asset allocation models are populated by fiduciaries who have no interest in the particular investments that are used to populate it, but then they are actually presented to the participants by other individuals.

MS. SUPOVITZ: Yes.

MR. TAYLOR: I just wanted to make clear. Do those individuals have interest in that?

MS. SUPOVITZ: No, no, no.

MR. TAYLOR: Okay.

MS. SUPOVITZ: Those individuals, to give you an example, they may even be part of the HR department of the company --

MR. TAYLOR: Okay.

MS. SUPOVITZ: -- or they may be hired educators or enrollers that are paid nothing to do with the investment.

MR. CANARY: All right. Thank you very much. I think with that we'll resume again at 2:15 with the next panel after a lunch break.

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(Whereupon, at 1:16 p.m. the hearing in the above-entitled matter was recessed, to reconvene at 2:15 p.m. this same day, Wednesday, August 12, 2015.)

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

(2:15 p.m.)

MR. HAUSER: So if everyone wants to get settled, we'll start up with the afternoon panels. Would you like to start?

MR. POOLMAN: If you'd like me to.

MR. HAUSER: Do you have a preference? Whoever wants.

MR. POOLMAN: I'd be happy to if you'd like that.

MR. HAUSER: I would just remind, if you weren't here in the morning, if you could all remember to speak into the mics for the benefit of the people that have to transcribe this. Thank you.

MR. POOLMAN: I'm going to go ahead and get started then. Thank you. I appreciate it and thank you for the opportunity to testify today. My name is Jim Poolman and I am an executive director of the Indexed Annuity Leadership Council, which is a consortium of life insurance companies that offer fixed indexed annuities or FIAs. Established in 2011, the IALC educates consumers, the media, regulators, and industry professionals about FIAs. IALC companies today have more than 1.3 million policyholders in force, with more than $84 billion in assets.

At the outset I want to recognize the thousands of insurance agents who sell fixed annuities including FIAs and who work very hard every day to provide principal protection and guaranteed income to consumers. Extending a legal fiduciary standard to their conduct will reenforce what is already largely true today, in almost every case these hardworking men and women work to advance the best interest of their customers. But the details of the DOL final rule will make the difference between a standard that reenforces that desired conduct and one that may impede the ability of insurance agents to help consumers navigate important retirement planning decisions.

Fixed annuities, including FIAs, have been used by consumers for many years as part of a well-balanced financial plan and as a way to provide guaranteed income for life. The only significant difference between an FIA and other fixed annuities is the formula for computing interest earnings credited to the policy. The FIA references a market index for that purpose instead of a periodically declared or fixed rate.

As is the case with other fixed annuities, FIAs do not assess sales charges. They are supported by the general investment account of the insurer, principal is protected from market downturns, and they are regulated by as insurance under state insurance laws, and they are sold only by state licensed insurance agents. While sometimes these agents are also registered investment advisers or registered representatives of a broker-dealer, the majority are independent insurance agents selling only insurance products.

The IALC appreciates the Department retaining PTE 84-24 to provide an exemption from prohibited transactiion rules for insurance agents who sell fixed annuities for the purpose of preserving the traditional commission form of compensation. Unlike the proposed best interest contract exemption, 84-24 reflects the dominance of independent insurance agents who sell these products and who typically do not offer other financial products. It also reflects the absence of sales charges assessed to the policyholders purchasing fixed annuities and the reliance on insurance commissions as the form of remuneration to the insurance agent.

84-24 is structured with the intention of making available financial advice that is a consumer's best interest notwithstanding the payment of commissions by third parties. Our comment letter offers several suggestions to modify the language of 84-24, some of which are technical and clarifying in nature. While not enumerating them all today, each is nonetheless important to make the rule work as intended. I will mention just a few of the substantive areas that we urge the Department to address in the final PTE.

The first issue is the definition of insurance commission, has three distinct issues. One, it seems to require payments directly from an insurance company to the insurance agent. However, commissions may be paid to an insurance agent by a broker-dealer with whom the agent is a registered representative or by an independent marketing organization with which the agent is contracted. Two, using the term "sales commission" to define insurance commission is too vague. And three, the complete elimination of marketing payments will impair the ability of insurers to support activities that are important to the distribution process.

Our comment letter suggests addressing these concerns by defining insurance commission as all taxable income. We suggest including sales incentives and marketing payments only to the extent that they are based on total aggregate sales.

The complete elimination of these payments is unnecessary to minimize the risk that an insurance agent might be motivated to recommend a specific product on the basis of a potential payment, rather than what it is in the best interest of the consumer. The risk can be addressed by preventing such payments when they are tied to a specific product, yet permitting them when they are paid on the basis of total aggregate sales.

Why do they need to be preserved? Because these payments support activities that are important components of the distribution process. For example, the elimination of marketing payments to agents would be a disservice to consumers as it is the advertising by agents that actually brings greater awareness to consumers about the financial products available, the companies that provide them, and how consumers can obtain them.

The second issue, one of the conditions of the PTE is that the insurance agent not be paid amounts in excess of reasonable compensation. We believe that it is important to have a very clear definition of what reasonable compensation is to be able to comply. We urge the Department to adjust the definition to be clearer. Specifically, we urge the adoption of a safe harbor, a standard used in the regulations under ERISA, section 408(c)(2), a section that allows fiduciaries to receive reasonable compensation for services. That regulation defines as reasonable, "such amount as would ordinarily be paid for like services by like enterprises under like circumstances."

The third issue, the PTE requires an insurance agent to disclose the insurance commission to the customer expressed on a percentage of gross annual premiums that is paid by the insurance company to the agent. As drafted, this requirement raises two concerns. Some forms of commission may not easily be described as a percentage of premiums. For example, health insurance or retirement benefits earned by the insurance agent and as I described earlier sometimes such payments are made by entities other than the insurance company.

Therefore, we urge the Department to clarify that the disclosure applies to commissions received without reference to the entity making the payment and that the disclosure be expressed as a percentage of premiums to the extent feasible and otherwise as a dollar figure with any applicable conditions and limitations explained. Our recommendations further the purpose of the PTE by ensuring fulsome disclosures of commission payments.

With respect to the fiduciary rule itself, we urge the Department to add a seventh carve out to clarify that an insurance company does not become a fiduciary when assisting agents in communicating with their clients by providing an illustration or a quote. Illustrations can be important tools for agents to help customers help understand how a fixed indexed annuity works. Similarly, providing a quote to an agent should not somehow heighten the legal obligations of an insurance company. Our suggested carve out applies to those illustrations that are intended to comply with the relevant NAIC model regulation governing illustrations.

In conclusion, we've attempted in our comment letter and today's testimony to suggest constructive changes to the proposed rule, PTE 84-24, that are not intended to undermine the Department's objectives. We hope that a final rule will balance the Department's desire to expand the application of ERISA's fiduciary rule with the need to maintain a vibrant distribution system of financial products of retirement savings.

We believe that the thousands of insurance agents who will be subject to the best interest standards deserve standards that are transparent and fair, so that they can continue to serve the best interest of their customers. We appreciate the hard work that the Department has invested in this initiative and the courtesy it has extended to many of us.

I unfortunately was not able to attend the meeting that the IALC had with the Department of Labor, but we appreciate you being open to those meetings as well. We look forward to continuing to work with the Department as it modifies its proposals, so they will ultimately serve the best interest of all consumers.

MR. HAUSER: Thank you.

MR. BROWN: Good afternoon. My name is Dale Brown and I'm the President and CEO of the Financial Services Institute. With me representing FSI is Mark Smith, a Partner at Sutherland Asbill & Brennan. We are grateful for this opportunity to share some of our thoughts regarding the Department's fiduciary proposal.

The White House said when announcing the proposal that if you are willing to accept a best interest standard and give a few basic disclosures, firms could set their own compensation practices, thereby preserving choice for retirement investors. We agree with this objective.

I want to be clear. Since 2009, we have consistently supported a uniform fiduciary standard for all financial advisors that requires them to act in their clients' best interest. We share the Department's investor protection goals and believe that a well-crafted fiduciary standard will help investors. It is also vitally important that any final rule preserves investor choice and access to quality, professional retirement advice. Unfortunately, as currently written, the proposal is too complex and costly for firms and advisors to operationalize. It fails to achieve the White House's vision because it's unworkable; it creates barriers to professional advice; and it limits investor choice. We are ready to collaborate with the Department so that the final rule creates a workable fiduciary standard that preserves investor choice and access.

FSI member firms license more than 160,000 independent financial advisors, under both broker-dealer and RIA rules, representing more than 60 percent of all producing registered representatives. These financial advisors are small business owners in communities across the country, often in small towns where larger firms don't have a presence.

Due to their unique business model, FSI members are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their investment goals. Our members have strong ties to their communities and know their clients personally. They help their Main Street clients make good decisions when the market is volatile and navigate major financial decisions about retirement, college funding, and purchasing a home, for example. They are there when clients face significant life events such as medical concerns, deaths in the family, and caring for aging parents. They educate their clients about the importance of participating in employer sponsored and individual retirement savings programs. It is critical that investors retain access to a financial advisor they trust because no "robo-advisor" can hold their hand through life's difficult situations and decisions.

As written, the proposed rule will make retirement advice too expensive for investors that typically utilize commission-based accounts. Research from a variety of sources has shown that investors who work with financial advisors save more and are better prepared for retirement. For example, an April 2014 study by Quantria Strategies found that retirement savings balances are 33 percent higher for individuals who have access to financial advice. The same study also found that limiting access to retirement advice leads to more investors cashing out their retirement plans and could reduce the accumulated retirement savings of these affected investors by up to 40 percent.

Mark will now dive into more detail about the barriers raised by the proposal and our proposed solutions for how to develop a workable, uniform fiduciary standard that protects all investors.

MR. SMITH: Thanks, Dale, and in the interest of time, let me focus my comments today on the BIC exemption, but we'd be happy to respond to any questions you may have about other aspects of our comment letter.

And you all know this, since the enactment of ERISA in 1974, the Department has recognized that broker-dealers provide investment services essential to retirement savers. Consequently, the Department has over the years provided ERISA compliance structures that accommodate the commission-based broker-dealer business model. In our experience, this regulatory regime, coupled with the heavy federal and state regulation to which this industry is otherwise subject, has substantially succeeded in protecting the interests of retirement savers. In the proposal, the Department appears largely to agree with us. In more than one instance, the Department observes that in the main, retirement investors are well served by their financial advisors. And this industry can testify from long experience that if a bad actor does disserve a retirement investor, there are effective remedies available today. As we see it, the Department has been presiding over a success story here.

The Department, of course, proposes to remake this regulatory regime in the interest of enhancing investor protections for participants and IRA owners. The expanded fiduciary definition purposefully puts real pressure on the broker-dealer business model, and we appreciate the Department's effort to preserve the availability of commission-based accounts and thus investor choice through the proposed BIC exemption. The difficulty as we see it is that the BIC exemption as proposed simply is unworkable for participants and IRA owners, as well as for our members, and let me give you four high-level examples of that.

First, the proposed conditions governing compensation practices are not business model neutral. While commission-based compensation models remain available in form, there is no clear path through the exemption that our members can rely on with confidence. The proposal leaves even good actors substantially exposed on this point. And on a related point, the constraints on certain types of investments is neither neutral nor principle-based in our judgement.

Second, the written contract requirement is operationally challenging and inconsistent with industry practice and investor expectations. Simply put, no one will understand being asked to sign a contract before any concrete discussion of investment possibilities has taken place or any hiring decision has been made.

Third, the series of disclosures required by BIC -- the point of sale disclosure, the annual disclosure, the website disclosure, and, functionally, the data request requirement -- are complex, overwhelming for retail investors, and/or duplicative with existing disclosures. The BIC disclosures would also come at a real cost, which ultimately falls on participants and IRA owners. And to the extent the BIC disclosures implicitly require projections of future investment experience, they are also incompatible with other laws to which this industry is subject.

Finally, we like many others are greatly troubled by the prospect of a federal agency creating a private right of action under disuniform state law for a violation of a federal legal standard that itself is not created by statute. And at least in the circumstances of our industry, we can testify with certainty that ERISA fiduciary status and the best interest standard will be cited against our members in FINRA arbitrations and the other forums in which remedies exist today.

We should note that these consequences will fall more heavily on our smaller members than our larger members. The resource requirements to take on these conditions and exposures do not all scale. We had not thought that the Department intended to take retirement business away from smaller firms and give it to larger firms, but it may well be that the proposal will do just that, which is a particular problem in smaller communities.

The BIC proposal becomes unworkable and

impairs investor choice and access when it goes beyond the core White House concept of best interest and essential disclosures. In our comment letter, we suggested for your consideration alternative conditions that are closer to that core concept and consisting of:

A prudential standard to act in the client's best interest; to provide skillful, careful, and diligent advice based on the client's needs; and to disclose, avoid where possible, and otherwise obtain consent for material conflicts of interest; The adoption of written policies and procedures to manage material conflicts in reasonable and specified ways; and A more streamlined and focused set of disclosures at account opening on the web and at the point of sale that conceptually have much in common with the Department's judgments underlying the 404a-5 disclosures.

And this is a key point, as well as my final point. These conditions could serve not only as a solution under ERISA, but also for non-retirement retail accounts under other bodies of law. The Department itself argues that retail investors can find it confusing if different rules and legal standards apply to different accounts. It is also harder and more expensive for our members to serve clients if the Department, the SEC, FINRA, and the various other federal and state regulators with jurisdiction approach their common objective of investor protection in different ways. In the commentary, the Department heard from a number of these authorities about the importance of coordination with respect to the proposal and we cannot reiterate in strong enough terms that the proposal will fail in its objective of assisting retirement investors at the least possible cost to the retirement system, if functional coordination does not take place.

MR. BROWN: So I want to thank you again for this opportunity to share some of our thoughts regarding the Department's fiduciary proposal and provide some of our suggested alternatives. We are committed to working with you to improve the proposal In order to preserve accesses to professional retirement advice for all investors. And we encourage the Department to coordinate with the SEC and FINRA on a uniform proposal.

Thanks for your time. We're happy to answer questions.

MR. HAUSER: Thank you. Dr. Stanley?

MR. STANLEY: Thank you. My name is Marcus

Stanley and I'm the Policy Director of Americans for Financial Reform, a coalition of over 200 public interest, labor, civil rights, and business organizations that have come together to advocate for a stronger financial regulatory system.

Americans for Financial Reform supports the Department of Labor's proposed expansion of ERISA fiduciary duties. This expansion is long overdue. Over the 40 years since the existing DOL rule was written, retirement markets have transformed and workers have become overwhelmingly reliant on self-directed savings. Due to loopholes in the current rules, brokers providing advice on such self-directed savings can evade the fiduciary protections that Congress intended to provide to workers saving for their retirement through employment-based plans.

As extensively documented in DOL's regulatory impact analysis, effective regulation of conflicts of interest in investment advice should save retirement savers tens of billions of dollars annually. And there's been a concerted effort by some commenters to discredit this conclusion. However, none of the critiques we have seen has provided a convincing reputation of its fundamental findings.

A very wide range of independent studies using different sources and methods, ranging from the analysis of decades of mutual fund returns, to natural experiments creating random variance in investment practices, to mystery shopper audits of brokers giving financial advice, have consistently found strong empirical evidence that advisor conflict of interest lead to lower investor returns, particularly given strong theoretical and experimental evidence that markets for investment products are highly unlikely to be self correcting based on consumer choice alone. These findings provide powerful support for the commonsense conclusion that advisor incentives matter enormously to retirement investors.

Another conclusion one can draw from these findings is that an effective rule will face strong opposition from those in the financial sector who benefit from the current system. Gains to investors who are no longer steered into high cost products generally represent losses to the seller of the investment product. So the billions of dollars that investors stand to gain from an effective rule are also billions of dollars in reduced profits for Wall Street professionals.

The DOL must not weaken or reverse this rule in the face of criticism from those who profit through conflicted financial advice. If this rule did not impact the profit and the business models of some in the financial industry, it could not achieve its goal of benefitting investors. Furthermore, even in this initial proposal, the Department has already gone to great lengths to accommodate the concerns of financial professionals operating under potentially conflicted business models.

Rather than simply ban payment incentives that could create broker conflicts of interest, the proposed rule permits a range of such payments under the best interest contract exemption. So long as enforceable contractual protections are provided, conflicts are managed through appropriate policies and procedures and fee disclosures are made. In this respect, the proposed rule is far more moderate than the current regulatory scheme in the UK, which bans sales commissions all together. Under PTE 84-24, the proposed rule also continues to permit special exemptions for insurance agents who sell annuity products not defined as securities, despite the fact that many observers have singled out such annuities as having high potential for abuse.

Somewhat ironically in our view, critics of the rule are now saying that these accommodations to industry concerns are unworkable and impractical. Of course if there are reasonable operational changes that facilitate the process of establishing the best interest contract or communicating disclosures, then such changes should be considered. But let's be clear, if a company finds it impossible to enter into a legally binding commitment to put client interest first when giving advice or to change its policies to ensure that advisors do not face incentives that conflict with the best interest of their client, then it is simply trying to evade a real fiduciary commitment.

We are concerned that some in the industry will not be satisfied until all concrete and practical limitations on the conflicts of interest created by incentives to sales personnel or brokers are removed. This would reduce the fiduciary duty to a vague and general assurance that advice will be in the best interest of clients, even as the incentives for front-line advisors are structured to produce the opposite effect. A fiduciary standard will simply will not be effective without real, enforceable restrictions on high powered incentives to act against the clients' interest.

Even if nothing in the proposed rule is

changed, the Department will still face significant challenges in ensuring that the best interest contract exemption does not permit an appropriate conflicts of interest and that carve-outs for educational information and sales transactions are not abused. If the Department also permits the host of additional exemptions, exclusions, and accommodations requested by industry commenters, these challenges could become insurmountable. We urge the DOL to resist calls to weaken the proposed rule.

The Department should also not be distracted by calls to defer to other regulatory agencies. Through ERISA, Congress has entrusted the Department of Labor with the unique responsibility of safeguarding workers who save through employment-based retirement plans. Unlike the SEC or state insurance regulators, DOL's jurisdiction is not limited to particular types of financial assets, but encompasses all retirement savings that flow through employment-based arrangements. Given the central role of such retirement savings for middle class families and the special tax benefits that accrue to them, it is entirely reasonable that Congress designated these savings for special protections.

Only the DOL has the power to create a

consistent fiduciary standard that encompasses all employment-based retirement savings. And in practice, other regulators have not stepped forward with actionable and enforceable proposals to expand fiduciary protections in the areas they oversee despite the clear need for such expansion.

Finally, it should be clear that claims that the proposed rule will cripple access to investment advice for retirement savers are false. First is these savers who could least afford the hidden costs and the hidden fees of the current business model. Further there are numerous providers of fiduciary advice prepared to serve such savers at reasonable cost. Registered investment advisers already serve some 30 million clients under a fiduciary duty.

Organizations such as the Garrett Planning Network and the XY Planning Network provide face-to-face fiduciary investment advice for affordable hourly fees without any minimum asset requirements. And as discussed in the DOL's regulatory impact analysis, new developments in the provision of automated investment advice are allowing so-called robo-advisors to provide fiduciary advice at lower prices than ever before. Such technology may indeed be the wave of the future in investment advisory services.

It is telling that numerous comments in support of the proposed rule have come from individuals or organizations that already provide advice to low and moderate income clients under fiduciary standards, as well as organizations like Americans for Financial Reform that represent -- and our member organizations I should add, that represent many such savers.

Thank you for the opportunity to testify before you today. We greatly appreciate the extensive efforts the Department has made to reach out to all those affected by the proposed rule and look forward to further engagement.

MR. HAUSER: Thank you.

MR. PIACENTINI: Okay. I guess I'll start with questions for the panel and I'd like to start with Mr. Brown. So I understand that you're placing a lot of emphasis on preserving consumer choice. We've also heard some question in this hearing along the way that our analysis of the existing system didn't take adequate account of the existing protections. So the question I'm going to ask you -- actually I think I know at least most of the answers, but I want to make sure that I understand how some of the existing options work now for consumers.

So if I go to one of your members and I'm looking to make a decision between two similar mutual funds, but maybe they come from different families, okay, so I can see what the load is that I'll pay for each fund and I can see if I look what the expense ratio might be associated with each fund. So in that sense I know what I'm paying. But how do I know, do I know, what my advisor is being paid in connection with a recommendation of one fund or the other?

MR. BROWN: Actually, Mark is in a better to give you that answer.

MR. SMITH: Sure. Yeah, Joe, there is no mandated individualized account level disclosure of commissions as the regulatory regime stands right now.

MR. PIACENTINI: Okay. So let's say just hypothetically that these two funds have the same amount of front-end load. Am I correct though that the advisor might be paid a different share of that load depending on which of the two funds that they recommend?

MR. SMITH: Possible, not terribly likely. Given the compensation practices in the industry, it's very likely that the same level of compensation would flow through to the advisor.

MR. PIACENTINI: But depending on -- I

understand there are these things called pay-out grids --

MR. SMITH: Right.

MR. PIACENTINI: -- that determine the share that's paid out.

MR. SMITH: Right.

MR. PIACENTINI: Sometimes the amount that's paid out can depend not only on which fund is recommended, but on how much volume of that fund the particular advisor has sold and how much revenue that's generated for the fund family; is that correct?

MR. SMITH: I don't know that I can answer, I can confidently answer that one for you off the top of my head.

MR. PIACENTINI: Okay. So let's talk for a second about some of the ongoing charges. So 12b-1 fee, so I can see from the fund's prospectus whether there's a 12b-1 fee and how much it is.

MR. SMITH: Exactly.

MR. PIACENTINI: But I wouldn't know how much of that is or is not paid to my advisor?

MR. SMITH: Yeah, it's the same sort of structure as applies with --

MR. PIACENTINI: And so if the 12b-1 fee between the two is the same, the amount paid to my advisor though might be different between the two funds.

MR. SMITH: Yeah, and I don't think -- again, possible, not common, but possible.

MR. PIACENTINI: Okay. And I also can observe what the asset manager of the fund is paid, right, what the management fee is for the fund?

MR. SMITH: Absolutely.

MR. PIACENTINI: But I don't necessarily know whether that asset manager is paying some revenue back to the distributor, back to the advisor?

MR. SMITH: I think that is commonly disclosed these days in the product level

prospectus --

MR. PIACENTINI: Would I know the amount that was paid back to the advisor, whether that was the same or different for the different funds?

MR. SMITH: Not necessarily.

MR. PIACENTINI: Okay. So let's just hypothetically let's assume that I was able to come to acquire all of this information, so I knew in detail all of this for the different funds that were offered me. As a consumer then, how would that influence my decision?

MR. SMITH: Let me see -- try that one

again.

MR. PIACENTINI: So let's say that as the perspective investor, now I know what the load share is for each of the funds that would be paid to my advisor. I know whether or what share of the 12b-1 fee they would be paid, whether they're receiving revenue share from the asset manager and how much that would be for each of the funds. So now I have this information and I also perhaps have a recommendation now before me. The advisor is telling me that of these two similar funds, they think this is the better one to choose.

MR. SMITH: Okay.

MR. PIACENTINI: So maybe I can see that the better one, the one that's recommended is better has a larger load share paid to my advisor, but a smaller 12b-1 fee. I mean should that information have any bearing on how I interpret the recommendation and, if so, what kind of bearing?

MR. SMITH: Well, the investor of course has definitive information on what they're paying for the investment, correct, what the friction on the return from the investment is going to be. They have definitive information about that.

MR. PIACENTINI: Yes.

MR. SMITH: To the extent that this particular investor finds it instructive to understand what compensation is coming to the advisor -- and not all investors think about that in exactly the same way, right -- to the extent that they find it instructive, certainly there is information available in the system today to at least give them some order of magnitude notion of what kind of compensation is flowing into the distribution channel and ultimately to the advisor.

MR. PIACENTINI: Okay. So, if I can, I'd like to turn my attention and ask a little bit about how things work in fixed annuity market, because I understand that things are a little bit different there.

MR. HAUSER: I'm sorry, I'd like to ask one follow-up question from Joe's question, Mark. So assume, you know, we somehow manage to effectively convey the scope of the particular advisor's conflicts of interest. If I'm an investor -- and it's sometimes positive that that kind of disclosure is, you know, an alternative and perhaps better way of dealing with conflicts of interest and their impact than what we've proposed.

So back to the question, so suppose I got that level of disclosure. I'm an investor looking to you for, you know, expert assistance in making an investment decision that I'm not really competent to make without your assistance. What good does that disclosure do for me? How do I translate the fact that you've told me you have a conflict of interest and to better investment decision-making? Can you think of any way to do that?

MR. SMITH: That the possession of that kind of information by the investor translates into better investment decision-making?

MR. HAUSER: Right. I mean it seems to me that would be the point of disclosure. But one of the things that's always puzzled me about it, well, okay, so I have that information, what good does it do for me in making a better decision? And I haven't been able to think of the way it does. Can you?

MR. SMITH: Sure. I mean isn't -- the point is that you've provided more information to the investor that lets the understand the filter through which the recommendation is coming and make a judgment about whether that's a recommendation that they want to take into account or not. Isn't that the point of the disclosure?

MR. HAUSER: Well, I mean, so the self --

but that maybe tells the investor they should be on guard on whether to trust you at all. But assuming -- you know, and maybe they should go to somebody that doesn't have a conflict. But how does the disclosure itself help if they stick with you in making a better investment decision or does it? Is it's only function to kind of disclose you have a conflict so they can decide to go elsewhere or does it actually help people make a better -- how is it going to contribute to better investment results?

MR. SMITH: You know, I'll be glad to think about that a little bit more, Tim, and get back -- we'll get back to you if we have anything more to say about that.

MR. HAUSER: Okay, thank you. Sorry to interrupt.

MR. STANLEY: Can I say one? You already put your finger on the reason why a lot of us don't believe that a disclosure only approach to this is going to be effective because it puts people into a personal situation where they either insult the person across the table and essentially leave or set aside the information that they've received to some degree and that's just not something that's going to fix the problems we see out there.

MR. SMITH: Now if you would allow me? Our position is not that a disclosure only regime is appropriate here. Our position, and I think it largely mirrors the structure of the BIC exemption, is that a best interest standard supported by reasonable and sensible compliance procedures and a sensible disclosure regime is the appropriate solution to the issues that are on the table here. We are not advocating for a disclosure only approach here.

MR. HAUSER: Understood. Thank you.

MR. PIACENTINI: So if I could move to fixed annuities. So I understood you to improve our understanding of how the commissions work, that they're often paid through an intermediary. And then you talked about sales incentives. So are the sales incentives also paid through an intermediary or is that a reference to a payment to the intermediary or from the intermediary to the actual salesperson?

MR. POOLMAN: I wouldn't say that most are paid through an intermediary. They may be paid directly from the insurance company. But in some cases, the distribution process allows for an independent marketing organization to have some sort of contract where the independent marketing organization is working with the agent on whether it be training, whether it be, you know, other contractual issues that they may enter into agreement with. That compensation may in some cases flow through them. And so that's what I was trying to articulate in my comments.

MR. PIACENTINI: Okay. And so these intermediaries and the sales forces below that, in at least some instances they're independent, so they're selling products of multiple carriers?

MR. POOLMAN: Correct.

MR. PIACENTINI: Okay. So if I understood correctly, you thought that the -- the sales incentives you described that are based on total volume of sales, that those don't have the effect of potentially influencing a recommendation of one product or another because they don't depend on which product, just on volume. But could they have the potential of influencing the choice of which carrier's product to recommend?

MR. POOLMAN: Potentially. But what I would say to that is that if you're representing a number of different companies and the consumer is sitting across from you and you're using the proper disclosures that we've described in our comment letter and, you know, assuming the changes are made that we think adds value to the consumer, then they can say I want to see all of the products that you have potentially available and compare and contrast the disclosures that are available to them in terms of compensation.

MR. PIACENTINI: Okay. I asked Mr. Brown this question with respect to his area and he said that the commissions don't usually vary that much between similar products. What about with respect to the fixed annuities from different carriers and so forth, do the commissions tend to cluster very closely around a single point or is there more variation? Just generally what is the type of level --

MR. POOLMAN: Yeah, I think that's a great question and my response would be that they are pretty compressed as well. You know, they may vary a little bit, but typically pretty compressed. And that's one of the things actually we mentioned in our comment letter, is to provide some sort of standard by which would provide a safe harbor because we think that there is that. If you're on the outliers, which you probably shouldn't be on the outliers, then that would bring that outlier back into that bandwidth that we're talking about and that would give a consumer basically a built-in protection there.

MR. PIACENTINI: Okay. Another question, if

I understood correctly, you said that most of the sales force for these products typically sales only insurance products --

MR. POOLMAN: Correct.

MR. PIACENTINI: -- not securities.

MR. POOLMAN: That's right.

MR. PIACENTINI: So do the customers typically come already having decided what they want is an insurance product and well understanding what that means by that limitation; for example, not a variable annuity that's a security? And if not, then what happens if the customer comes in and it turns out that really what they should be looking for is something, at least in part, other than an insurance product?

MR. POOLMAN: Sure. Well, let me start out by saying, yes, you know, many of those folks are selling insurance only products --

MR. PIACENTINI: Yes.

MR. POOLMAN: -- and will, you know, offer a fixed indexed annuity product. That does not mean -- and this is -- one of the things that we addressed in our comment letter was suitability and that the NAIC has passed suitability standards. In fact I was a former insurance commissioner and was in charge of the first round of suitability at the NAIC, which is a very valuable standard for consumers. So (a) they're looking at whether or not that product is suitable for them and so is the company for that matter; but if a consumer does not see that a fixed indexed annuity is going to work for them, they certainly have the ability to go elsewhere, but they won't be able to buy a securities product from that particular agent.

MR. PIACENTINI: In other testimony earlier in this hearing from the perspective of a variable annuities, there was some suggestion that they should be in the same exemption, eligible for the same exemption as fixed indexed annuities or other annuity products because from the point of view -- at least one possible reason being from the point of view of the consumer, they actually look kind of similar, right. They might have similar insurance features built in. They might similarly change value with the market, for example. So that although behind the curtain they're very differently structured product, differently regulated product, from a consumer protection standpoint they might be similar. Does that fit well with any standard how these products look from the consumer side?

MR. POOLMAN: I don't want to sit here and take a position on whether a variable annuity should be included in 84-24, but I would say that the distribution systems are different. You know, BIC is targeted to a fee-based product and this is not a fee-based product. I mean there are a whole host of other issues out there that we believe 84-24 fits for fixed-indexed annuities and a lot of that is based on distribution than how the product is structured.

MR. PIACENTINI: Okay. Let me circle back for just a second because I'm realizing when I was asking about commissions, I think I forgot to ask, what typically is the level of commission that's associated with a fixed index annuity sale?

MR. POOLMAN: We asked that question internally. Without violating any antitrust obviously issues that might be out there, but we tried to get a survey and it's about six to eight percent give or take. And that's what I mean about that fairly narrow band of compensation paid to producers out there.

MR. PIACENTINI: Six to eight would be a representation of a narrow band?

MR. POOLMAN: Right.

MR. PIACENTINI: Okay. So then my last question for the panel and I'd welcome an answer from anyone on the panel to this. But I've heard from this panel and from a lot of folks in this hearing that there's broad consensus that the best interest standard is a good idea. In fact in some instances folks are already honoring such a standard even if they're not necessarily legally held to one.

I guess my question is, there is now sometimes variation in what's paid to an advisor depending on what they recommend. And presumably there's some market reason why the asset suppliers are paying different levels of compensation sometimes for similar products. So my question is, if we have an enforceable best interest standard and people really do follow it and everybody else in the market understands it's being followed, would some of that variation just naturally begin to disappear? Would there be less reason to variably compensate a salesperson if you knew that they could not, would not be taking any consideration of that variation into account when they made their recommendation? Would the variation diminish in market? Anybody wants to --

MR. POOLMAN: I don't think anybody wants to take a stab at prognosticating what the market may do, but --

MR. PIACENTINI: That's why it was my last question.

MR. STANLEY: Well, I'll take a stab although with the proviso that if I knew what the market would do, I'd be a lot wealthier than I am now. But we do believe that variation would diminish because frankly we believe that some of that variation is out there to induce people to buy particular -- or to induce people to prioritize particular products and the advice they give. So we do believe that variation would diminish and we believe that some products actually also might disappear from the market because there are some complex products that are sold to retail investors that are just dominated by other products on the market that are in the best interest of a very, very few if any investors. So we do believe that there would be real market changes.

MR. PIACENTINI: Thanks.

MS. HALL: I have one question for Mr. Smith. In your testimony, in your written and oral testimony, you said there is no clear path through the exemption that our members can rely on for confidence. And I suppose you're talking about the BIC exemption.

MR. SMITH: Yes, ma'am.

MS. HALL: Can you elaborate on that a little bit more? Because it sounds like you're saying you don't understand, you need a little more clarity, not that you can't.

MR. SMITH: You're right. And let me speak to this point. We see no structural reason why broker-dealers cannot serve the best interest of their clients. There's a premise in that, several premises in that, one of them including the market reality that there are variations in compensation among product types and among product manufacturers within a type does not by itself mean that advice cannot be in the best interest of the investor.

We see some indications in the preambles that you all see that the same way. There are a variety of compliance procedures that under the warranty or otherwise that are part of the exemption. We see some indication that you all think approvingly of, for example, some of the FINRA procedures with which our members are very familiar.

We're trying to get from the concern -- well, we're trying to get to -- we're looking -- it really is a question of -- if I'm right about all of that, then it's really a question of certainty. It's getting from the this might work under the exemption, to this would work under the exemption. And to the extent you can help us get there, then it seems to us the workability of the BIC exemption improves in a material way.

And in particular on my point about neutrality among business models, to the extent that you can give us greater certainty that there is a path through the exemption that a commissioned-base model in economic realities of today's marketplace can accommodate, then that is a significant advance in terms of the work -- it would be a significant advance in the workability of the proposal.

MR. HAUSER: Okay, thank you. May I just ask, you know, one thing to think about, not just for you all, but for all the folks we've talked to, if you're going to submit additional comments, more comments on that precise point would be helpful.

You know, we indicated in the exemption that we did not intend to adopt a level fee structure, that we weren't mandating a level fee structure, but we were and did intend to prohibit, you know, incentives that were contrary to a best interest standard and that we didn't want to -- well, I guess what I'm saying is it would be helpful to get some suggestions as to what those policies and procedures might look like.

I mean virtually everybody who has come in here to talk to us has said that they think they act in their customer's best interest. They support a best interest standard. It seems like if that's the case, there would be policies and procedures extant that, you know, are calculated to avoid rendering advice that runs counter to the customer's best interest. But it's concerning for that reason that so far we haven't gotten just a flood of, you know, suggestions of, well, here's a policy and procedure you could use as an illustration. And so I would just invite everybody, you know, to give those kind of examples if you think you've got them.

MR. SMITH: We'll be glad to and, look, we've got one. We think that the FINRA conflict of interest report from 2013, which you all cited approvingly in the preamble, we think that provides

a -- certainly within the circumstances of our industry, we think that provides an effective model for addressing those sorts of conflict sorts of procedures.

MR. CAMPAGNA: Mr. Poolman, I would like to explore with you a little bit your suggestion as to the safe harbor or the carve-out regarding illustrations. Maybe I don't quite understand how it would work or maybe there's not enough detail, but it kind of rings a bell in my mind about our investment carve-out regarding a description of the investment alternative being offered, type of risk. Is there anything I'm missing here or is there something unique about your --

MR. POOLMAN: Let me just give you a little background, if I can, about an illustration. Many times an illustration is used to explain the benefits and educate consumers about the product. Insurance companies provide an illustration to the agent to give to the customer. And our suggestion, our only suggestion there is that the insurance company, they not be held as a fiduciary only because they're giving a piece of educational material to the consumer.

The NAIC just not too long ago passed a disclosure model basically that is very specific about what should be included in that illustration and we see that as the standard by which insurance companies will follow to be able to utilize that illustration and so, therefore, the insurance company is not sitting down at every sale when that illustration is being used. Thus the company ought not to be declared as the fiduciary.

MR. CAMPAGNA: Dr. Stanley, there's a great deal of discussion earlier today and in the last couple of days about excluding from our definition or actually re-including this idea of mutuality in this agreement or understanding. Your comment letter kind of went the other way. You said by virtue of a specific investment -- or a specific direction to make an investment, that should be determined to be an understanding. So did you want to weigh in at all about this debate that we're kind of having?

MR. STANLEY: Well, I think the concern was that if the advisor can essentially veto the idea that a contract was entered into by saying, well, I didn't understand that, if it becomes a sort of subjective situation where the advisor can simply deny that he had an understanding that there was an agreement to provide advice, even if the sort of more objective circumstances would indicate that a piece of advice was being given and the client said that he understood that as advice, then that would be a concern to us.

MR. CAMPAGNA: Mr. Smith, I'm going to take you up on your offer to discuss your comment letter a little bit. You wanted to extend the platform provider carve-out to IRAs.

MR. SMITH: Yep.

MR. CAMPAGNA: And you talked in terms of, well, if there's a set menu or a standardized product that's being offered, that shouldn't be included or we should, you know, put that into the safe harbor, adopt that to IRAs. Can you illustrate to us or tell us a little bit about this standardization process and how it actually works? And is there any discussion with the IRA owner at all regarding how it's going to be set up? Are there any discussions with the client?

MR. SMITH: Well, certainly at the point of sale, there certainly are discussions going on with the client as always about the nature or the opportunity, certainly its pertinent terms, how it might fit with their needs and tolerances and so forth. It's certainly the case that's going on at the point of sale. The question is whether just being in the marketplace, in terms of offering an IRA and an IRA that's not an open-ended, self-directed IRA, but an IRA that may be tied to a particular product, tied to a particular product menu, IRA tied to a particular asset allocation I suppose.

Just being in the business of offering that is not -- doesn't rise to kind of fiduciary activity in and of itself. It's a comparable concern to the platform exception as it stands for the qualified plan market and it seems to us that there's simply a comparable point to be made about folks that are in the business of offering IRA platforms as well.

MR. CAMPAGNA: Do you agree at all with the rationale as to why the IRAs aren't included that we stated in our preamble about plan fiduciaries get a chance at least to look over this menu, but in the IRA context that's not the case. I mean, how would you rebut that?

MR. SMITH: We distinguish between kind of the business, just being in the business, offering for sale, you know, plan platform, IRA platform, just being in the marketplace from what's going on at the point of sale. We don't think that turns on whether there's a fiduciary in between the offeror and the retirement investor that's making a judgment about that. We think it's simply -- we simply think it being in the business.

MR. HAUSER: Well, when you're thinking about a platform provider exception in the IRA market, so, I mean, obviously one way to interpret what you just said is it's always open to a financial service provider to say here's what I have to offer --

MR. SMITH: Right.

MR. HAUSER: -- this is it --

MR. SMITH: Right.

MR. HAUSER: -- you know, make up your own mind. I'm not recommending anything to you.

MR. SMITH: Right.

MR. HAUSER: That's one view. Another is extending that to an actual recommendation. You know, I have narrowed the universe of investment options down to these, you know, and you should rely upon them. You're not looking for a carve-out for that in the latter circumstance are you?

MR. SMITH: We're looking -- and, Tim, you know, the points you've made earlier about the limitations of a recommendation FINRA sense does not help to answer this question, I think it does help to answer this question. But it does seem -- we're talking about conceive of a spectrum that has arm's length sales activity at one end, trusted investment advice at the other end, and we're trying to define, when you go from one to the other, in a way that 404 and 406 and 4975 ought to be in play, right?

MR. HAUSER: Yep.

MR. SMITH: And it seems to us there's something useful about approaching that from both ends of the spectrum. That seems to us useful conceptually and useful operationally as well. And we're

focused -- you know, the absence of a recommendation in the FINRA sense to any particular investor is helpful here. To the extent that we can make that even clearer through the platform exemption, I think that gives some additional comfort to our members in the market. That's the point.

MR. HAUSER: I see. Thank you. And I'd to go back to the policies and procedures and in particular to the requirement in the best interest contract exemption, variously been referred to as the BICE or the BIC exemption. Personally I think the best interest contract exemption is very musical.

MR. SMITH: Hard to dance to.

(Laughter.)

MR. HAUSER: But the idea, you know, the idea of that exemption on the whole is that at some level, we're going to tolerate a fair number of compensation streams that normally would be flatly prohibited because of the potential, you know, incentives they create for the people recommending the products. But the idea of that warranty prohibiting incentives and quotas and bonuses and what have you that, you know, that run contrary to the best interest standard is that we want policies and we want incentives that align the advisors' interest with the interest of the customer.

So I guess my question, which, you know, maybe is the way I should have put it the first time around was, I mean, is that naive? Is there some reason why -- the firm can price these products however it wants -- you know, the manufacturer can. But when it comes to the guy delivering the advice to the customer, is there some reason why you can't, you know, warrant that that person is not going to be given an incentive to do -- you know, to push the product that isn't the right one for the customer, you know, that isn't prudent, that runs contrary to the best interest standard?

MR. SMITH: I don't think it's naive to think that we can do that.

MR. HAUSER: And then the other thing and I guess just a cautionary word, I mean, you know, a lot of folks have given guidance and we have received some suggestions on policies and procedures and you did make some suggestions. But one thing I'm at least thinking hard about as I look at these suggestions is lurking in these policies and procedures, is there a sense in which the firm's conflict of interest is just being directly transmitted to the advisor?

And that would worry me. If the policy and procedure essentially says the more money this recommendation will make for the firm, the more money I'm going to pay you, that's aligned all right, but it doesn't necessarily seem like it's aligning the advisor's interest with the customer. So I guess there's not going to be a question there since we're out of time, but if you could think about that when you --

MR. SMITH: We'll be glad to think along those lines.

MR. HAUSER: -- and provide comments. Thank you. Thank you very much.

(Panel switch.)

MR. HAUSER: Let me know when you're set. Okay. Ms. Rittenhouse?

MS. RITTENHOUSE: Okay. Good afternoon. I'm Linda Rittenhouse --

(Timer chimes.)

MS. RITTENHOUSE: Already?

(Laughter.)

MR. HAUSER: We have to get a little tougher now because we're towards the end.

(Laughter).

MS. RITTENHOUSE: I'm Linda Rittenhouse, Director of Public Policy, a CFA Institute. We appreciate the opportunity to offer our views today on the recent DOL fiduciary duty proposal. We know that this has been a controversial endeavor and we commend the Department for stepping into the fray.

CFA Institute is a global membership organization of more than 133,000 members in 151 countries with over 125,000 holding the Charter Financial Analyst or CFA designation. Our membership is diverse, including investment analysts, portfolio managers, chief investment officers for mutual funds, private wealth, pension funds, and other investment professionals. It is as a representative of this diverse group that I'm happy to provide comments on the DOL's effort to hold advice providers to the best interest standard when serving ERISA retirement plans and IRA account holders.

Regardless of their profession, all CFA Institute members are bound by the commitment to abide by the CFA Institute code of ethics and standards of professional conduct. This requires all of them to act for the benefit of their interest and place their client's interest before their employers or their own. They all must specifically act with loyalty, duty, and prudence. These are not light undertakings. Members must attest on an annual basis to their compliance or risk losing their charter.

Thus we strongly support DOL's aim to put clients interests first. We have long said that all personalized investment advice should be held to the same standard regardless of the title of the provider, be it broker or advisor with an "o" or counselor. We applaud the DOL for taking this important first step to actualize this objective.

Retail clients, all investors, should be able to trust that the advice they receive is impartial and not compromised by conflicts of interest that may arise from revenue sharing arrangements or limiting recommendations to certain firm products. Otherwise what happens to the integrity of our marketplace?

While the proposal is not perfect, it does start from a place that seeks to restore this original intent of ERISA that requires duties of prudence and loyalty. We've been impressed with your stated willingness to consider all comments raised and to acknowledge areas that are in need of redraft or clarification. We've also appreciated your attitude that we've heard on numerous occasions that your intent is not one of gotcha, but instead of investor protection. Thus, your willingness to clarify areas that have been problematic, most specifically the best interest contract exemption, bodes well for making this final rule much more workable.

So now to the actual proposal. We wholeheartedly agree that the current five-part test is inadequate, does not honor the statutory definition of fiduciary and allows for conflicted advice, higher costs, and the sale of inappropriate investment products to investors. Committing to replace this test alone we feel is a major step forward in providing investors with the protection they deserve.

We also strongly support the rule's carve-out from the definition of investment advice that allows a range of educational materials to be provided to investors. We have a longstanding position that investors must receive the information they need to make informed investment decisions. This is never so important as today when individual investors have greater responsibility for understanding their retirement options, planning their future, and managing their retirement assets through participant directed plans. Simply, they need the educational tools. We encourage the final rule to retain the provision that neither the frequency nor the form of these materials really matter as long as they do not include advice or recommendations as to specific investment managers or products.

We also are not convinced that requiring all advice providers to adhere to a fiduciary duty or meet the conditions of the best interest contract exemption will eliminate all retirement advice with a smaller investor. Nor do we agree with the argument we've heard that conflicted advice is better than no advice at all. Instead, we believe that investors will continue to receive the retirement advice they need and technology and providers will step in to fill whatever void is probably temporarily created.

We do have some concerns about the proposal, however, that fall primarily into this best interest contract exemption realm. First, we do believe that proposal as written is too complex. This complexity and the resulting confusion will lead to unnecessarily high compliance costs and ultimately dilute the effectiveness of it. When the duty to comply first arises, whether the advice provider can have preliminary conversations and how the sequence of events will work on a practical level all need to be addressed. We urge the Department to specifically discuss the parameters of when certain actions will first trigger the responsibilities under the exemption.

We also encourage a review of the numerous actions required under the exemption with an eye to streamline those that are not necessary for achieving this best interest standard. For example, we note in our letter, comment letter, that the proposed point of sale disclosures are too onerous as drafted, and instead we recommend consideration of a Surgeon General type warning discussed in the proposal.

Secondly, we also hope the Department will provide more comfort as to when legal liability will attach. We support the new private right of action for IRA account holders, but understand that this and execution of contracts create concerns in the industry. We also understand the trepidation caused by just entering into contracts and the resulting legal costs to defend actions when recommendations are later questioned by investors, even if the contract was executed correctly. To that end, we encourage the DOL to issue guidance or discuss more directly in the final rule the areas that most likely will lead to legal liability, so that the industry has more certainty about the rule's boundaries.

Third, we are concerned about investor confusion that may arise from the standard of care that applies to the retirement arena, but not other areas. While the DOL is creating a best interest standard for all advice providers under ERISA, the SEC has not yet introduced a uniformed standard that will apply to all who provide personalized advice to retail investors. As a consequence, we're concerned that investors may expect a broker-dealer, who is providing retirement advice, to also be honoring a best interest standard when advising as to non-retirement assets. We encourage the DOL then to work closely with the SEC when finalizing this rule to reconcile to the degree possible this investor confusion issue.

In sum, we support this undertaking. We suggest that the DOL consider all reasonable ways to simplify the exemption, to reduce the compliance cost, to better define the parameters of when duties kick in, and to clarify legal liability under the rule, so as to more clearly define the risks. Finally, we hope that the Department and the SEC will consult closely in adopting the final rule.

Thank you.

MR. HAUSER: Thank you. Ms. McBride?

MS. MCBRIDE: Thank you. I am Kathleen McBride, an Accredited Investment Fiduciary Analyst and a CEFEX Certification Analyst with the Centre for Fiduciary Excellence, CEFEX. I serve as Chair for the Committee for the Fiduciary Standard, a non-partisan, all-volunteer group of investment professionals and fiduciary experts, formed to advocate that all investment and financial advice be rendered as fiduciary advice and meet the requirements of the Committee's five core fiduciary principles. All of the Committee's work is pro bono.

The five-core fiduciary principles are put the client's best interest first, act with prudence, that is the skill, care, diligence, and good judgment of a professional, do not mislead clients, provide conspicuous full and fair disclosure of all important facts, avoid conflicts of interest, fully disclosure and fairly manage in the client's favor, unavoidable conflicts.

We are challenging the status quo to ensure that all Americans can achieve a dignified, secure, retirement. I testify in support of this DOL Rulemaking. It is long overdue. I'll touch on three topics today: rollovers and harm to investors, debunking the myths about the DOL's proposal, and the perverse effects of disclosure.

Thank you for proposing a strong fiduciary rule that will eliminate many conflicts of interest that harm America's retirement investors. Americans who work and sacrifice to invest for their retirement should not have their nest egg diminished by Wall

Street and insurance companies that place their own interests before the retirement investors they are supposed to serve. Their short-term greed ensures only one that America's retirees will not have the spending power in retirement that's good for the economy, that they could have with advice that's in their best interest.

We applaud DOL for prohibiting a seller's exemption for retail investors, including IRA owners. DOL has proposed a rule based on the North Star of fiduciary obligation and that is paramount. Now we will finally close the unintended loopholes that enabled the systematic looting of assets from America's retirement investors for decades.

DOL has used its rulemaking authority to include IRA investors under this proposal, including advice on whether it is in their best interest or not to roll retirement plan assets from 401(k)s into IRAs. This has been an investor crossroad that's vulnerable to spectacular egregious harm, a wild west of abusive strategies by some of the industry entities to grab enormous amounts of retirement money from hard-working retirement investors just as they will need this money most.

When retirement investors are making the decision whether or not to roll retirement savings into an IRA, they are at their most vulnerable. This fact is not lost on non-fiduciary sales reps of banks, broker-dealers, insurance companies, and mutual fund companies. It is the subject of enormous planning, strategy and training at firms that seek to capture retirement investors' assets, along with unreasonably high commissions and fees.

And it is here that retirement investors are often caught off guard. As one behavioral economist, who has done much research on the effects of disclosures in advisor and investor behavior, points out: "It is very hard to say 'no' to the representative sitting at your kitchen table, even if you know that what they are telling you to do is not in your best interest."

Here's an example, one investor, a Navy vet who went into the private sector after the Navy, accumulated a combination of traditional, defined benefit pension plans, and 401(k)-type plans. He was the beneficiary of two multibillion-dollar pension plans, which send retirees a monthly check for life. Shortly after his 65th birthday, he got a phone call from an advisor claiming to work with one of the traditional pension plans. He wanted to discuss this retiree's retirement situation. This advisor began by asking whether this retiree was confident he'd have enough to live on for the rest of his life.

This advisor insinuated that the Fortune 40 and Fortune 15 companies with the traditional pension plans might go out of business, taking this retiree's monthly payment with them. What would he do then? This advisor strongly urged this retiree to take the lump sum payouts from his two pensions -- six-figures -- and put his money into a guaranteed annuity in an IRA at this mutual fund company, a major one. Sure, it would pay this retiree several hundred dollars less each month than the pension plan would pay, but it would be guaranteed. He hounded this retiree until this retiree did rollover one of his pension plans to an IRA at that fund company, ready for that annuity.

It is too late for this retiree to reverse his lump sum pension payout, so he now has to find a way to replace that retirement income his pension would have provided for life. He did not buy the annuity by the way.

While he will not be taking more advice from this advisor, the harm has already been done. This happens every day to thousands of America's retirement investors and this is the model that Wall Street and insurance special interests seek to protect.

Let's be clear, conflicted advice is not advice. It's sales masquerading as advice. Bona fide advice must be in the best interest of the investor. And when firms say that they will not provide advice if they have to be fiduciary, that's probably good for investors. To put it another way, brokers, banks, insurers, and mutual fund companies want to preserve the status quo that allows them to continue to systematically exploit unintended loopholes in 40-year old ERISA regulation and bleed retirement investors for every dollar they can grab.

But we know the fiduciary model works. Registered Investment Advisers already act as fiduciaries, in their clients' best interest. They're already serving plans and retirement investors as fiduciaries across all account sizes in retirement and non-retirement accounts. The DOL's proposal is workable, it is doable and, by the way, it is profitable.

RIAs are advising millions of investors. They now advise or manage $67 trillion through more than 11,000 RIA firms. They employ 750,000 individuals and serve 30 million clients.

As for small plans, fi360, which provides on-line tools for training and for advisors has tens of thousands of retirement plans that they actually can see data on. More than half of these plans are under $100 million. So there is no merit to the argument the small plans can't get fiduciary advice, they are, and that's just one small company segment.

Let's debunk some of the myths about the fiduciary standard for retirement advice.

Myth #1, it costs more to get advice from a fiduciary. Opponents to the DOL's proposal claim the fiduciary standard would raise costs to investors and reduce access to advice and investment products. That's not true. According to the latest fi360 Fiduciary Standard survey that measures attitudes of financial intermediaries' across the board of all kinds toward the fiduciary standard, the survey asked, "Do you believe it cost more to work with fiduciary advisors than brokers, when all costs to the investor are considered?" Ninety one percent of the respondents say no, it does not cost more to work with a fiduciary advisor than with a broker.

Many of the comments from the survey respondents indicate that instead of a higher cost to the investor to work with a fiduciary advisor, it actually costs investors less. There's a lot of academic research that supports this.

Myth #2, it would cost us too much to provide fiduciary advice. We'll have to pass those costs along to investors. The survey asked: "Do you believe a fiduciary standard of care would price some investors out of the market for investment advice?" Survey respondents say, no, it would not. Eighty-three percent say, no, the fiduciary standard would not price some investors out of the market for advice.

Myth #3, if we are forced to provide advice that's in the investor's best interest, we will abandon retirement investors. That threat sounds like blackmail and it's really bad form. Opponents of the fiduciary standard claim products and services would be reduced if brokers were required to act as fiduciaries. What they really mean is if they had to act as fiduciaries, they couldn't sell the high risk, high commission products that they sell now, because those would not be in the investor's best interest. And remember, brokers and insurance reps don't provide advice now and certainly not to smaller investors.

The survey asks, "Do you believe a fiduciary duty for brokers who provide advice would reduce product and service availability for investors?" Seventy-eight percent say no, fiduciary duty for brokers who provide advice would not reduce product or service availability to investors.

Many added comments, saying that this was an opportunity and that they would step up with additional fiduciaries to serve investors. In addition, a few wrote this would filter out products that may be suitable, but are not in the client's best interest and that's a good thing.

Just one second on disclosures. Disclosures are necessary but not sufficient to fulfill fiduciary duty. In fact, they are often ineffective or worse. The effects of disclosures are surprising and quite unsettling. Regulators may not be aware of the effects even good disclosures have even on well-meaning advisors and investors.

According to Daylian Cain of Yale, "Conflicts of interest can lead experts to give biased and corrupt advice, and although disclosure is often proposed as a potential solution to these problems, we show that it can have perverse effects. First, people do not generally discount advice from biased advisors as much as they should even when conflicts of interest are disclosed and, second, disclosure can increase the bias in the advice that leads advisors to feel morally licensed and strategically encouraged to exaggerate their advice even further. As a result, disclosure may fail to solve the problems created by conflicts of interest."

But worse, the most recent work on disclosures indicates that the effects are extremely perverse and that when disclosures are made, even well-meaning advisors give worse advice and investors are much more likely to take that advice.

MR. HAUSER: Thank you.

MS. MCBRIDE: Thank you for the opportunity.

MR. HAUSER: Thank you. Mr. Mason?

MR. MASON: I'm not quite sure it was great to go first or third here, but I'll adjust. My name is Kent Mason --

MR. HAUSER: Did we get the sequence wrong?

MR. MASON: Yeah.

MR. HAUSER: I'm sorry.

MR. MASON: My name is Kent Mason. I'm a partner in the law firm of Davis and Harman. I had to memorize that. I'm speaking today on my own behalf based on extensive conversations with plan sponsors and financial institutions and I very much want to thank you for the opportunity to appear here and thank you for your patience over what will be four days.

And I think my core message today is that the Department and the retirement community in general have a great opportunity here, a great opportunity to do a tremendous amount of good. There's also a risk of very significant harm and I think this -- or the sort of result of which path we end up going down is going to depend on whether the Department, the industry, and the participant groups can work together to sort of address some of the difficult issues sort of arising in this very important issue.

I think for the past four-and-a-half years and it's certainly very clear right now, there really has never been a debate about whether financial advisors should be required to act in the best interest of the customers. I think that the industry has been fine with that from the beginning. The debate has really in my mind centered on two questions. One, if the proposal is finalized in any form sort of similar to its current form, would the industry reduce services to small accounts and small businesses; and second, if that's true, how can the rules be restructured so that the Department can achieve its very worthy goals without that adverse effect?

And those are the questions I'm going to address. And I've spent a huge amount of time in the last few months talking to dozens and dozens of financial institutions and let me just describe to you what they're saying to me very, very clearly and very uniformly about what they would do under this proposal.

First, there is no financial institution I have talked to that would use the BIC or is even really seriously considering using the BIC exemption, none, zero. Now I've heard secondhand that there are a few who are thinking about using it. And my follow-up questions has always been, within eight months, and they go, of course not, no way we can do this within eight months.

So then the other questions are, well, could we change that result if we tinker? For example, let's fix the contract timing, would that change the result? No.

What if we sort of had assumptions for the one, five, and 10-year projections, would that help? No. Well, it would help, but would it change the result? Absolutely not.

What if we did something, we eliminated the web page? It wouldn't change the result.

This thing needs radical surgery and I'm going to talk about that in a minute. So because the exemption doesn't really exist, at least from all the financial institutions I've talked to, that means the brokerage model is rendered effectively illegal, which means that in the fall of '16, 20 million plus small IRAs are going to be told that they can no longer have access to a financial professional. Plans are being made today, financial institutions are talking about doing that right now because this is a long, long process.

So what are they going to do instead? Plans are already being made that when new money comes in, those financial institutions have no choice but to work with those people on non-retirement accounts. In other words, if you tell a broker working with a small saver that it's illegal to work with them on an IRA, they have to work with them on the non-retirement accounts. And again, people are actually spending time right now looking at expanding the non-retirement side of their business, because helping small business is going to be so much harder.

I've already heard from at least one major company saying that they're going to withdraw. They've already made the decision they're withdrawing from the small business market. They see the handwriting on the wall.

Investment education programs, many are going to be eliminated. And the reason is, it's sort of very simple, in the sense that if you go to a participant and say, you should be 30 percent invested in large cap funds and large cap funds and they come back to you and say, well, I don't really know what the means, do we have any in our plan, and you say I can't tell you, that's the definition of bad employer relations. They won't do that. So they will have to just -- for those programs, they'll just get canceled.

And financial institutions are already telling plan sponsors that the call centers will be instructed not to answer questions about investments, not to answer questions about distributions because the line is so low for crossing into advice. You can't take the risk.

So why? People say, oh, they'll never walk away from the $17 trillion in the market. It's not 17. It's walking away from the small accounts where you don't make money. You make money on the larger accounts. The smaller accounts are investment in the future. If it's totally impractical to work with them, they won't work with them. Now that's very, very clear.

And we've even seen the UK, the UK adopted a rule that has the identical effect as this rule, immediately triggered a massive exodus from the small account market. The UK has been in denial for two years. They finally admitted last week, there's a big problem and they launched a major review of the advice gap.

So how do you solve this problem? It's actually very straightforward. First, it's fine with the best interest standard. The second component is something has to be done about the seller's exception. Under the current proposal, it is crystal clear that the following is illegal. If a small business or an individual calls someone who provides retirement services and says I'd like to interview you to provide services, that interview is a fiduciary act and it's a prohibited transaction. That is crystal clear under this proposal. So nobody who provides retirement services can interview with a small business or an individual and that is flatfooted the way the rule works. So you need -- this would be about the only business in America that can't promote its own products and services.

Obviously I'm sort of in favor of preserving investment education instead of really, really wiping it out as I think this would do. And we need a workable prohibited transaction exemption. In other words, you don't need 40 pages. You need two rules. You need a rule that says you act in the best interest of your client, and you disclose your financial interest.

And that disclosure can be very simple and the simpler the better because simple is understood. I stand to earn, for example, a range of somewhere between 13 and 71 basis points on these funds that I'm recommending. If you want to know where any particular recommendation is in that range, all you do is ask me. This one is 22. That one is 68. I'll tell you exactly where it is in the range and I'll tell you why. What's wrong with a simple disclosure of financial interest?

Next, you need a workable transition. I mean we know, nobody can do this in eight months. I mean it's not -- you talk to people, their debate is not about eight months. They're thinking, gosh, can we do this in two years? No, no possibility. So if you really want this to work, you need a real transition period. Eight months, you know, nobody is even getting started in eight months. You're talking about three years. And we can't let sort of artificial deadlines dictate substance here. The right answer here is a real transition period such as three years.

And I think that sort of the two other points on transition is you need to protect advice that was given before the applicability date -- I have a little trouble with that word -- and you also need to protect advice that was paid for before the applicability date.

Let me just turn to my last point, which is good because it's less than a minute, and that is you've got 5,000 pages of comments. I mean I was amazed as I read all of the comments, how many different issues were raised and I kept reading comments and thinking, wow, I didn't even think about that. That's a great point. You have 5,000 pages of comments. The chances of getting it all right in one final reg, infinitesimal.

You need to re-propose. I mean I was really disappointed that before the hearing started, before the second comment, there was an announcement, you're going straight to final. That's sort of really doesn't pay much respect to the hearing process or the second comment period process. We need to have a second, people need to have a second look at this. They need to sort of see, have a good dialogue about, you know, how this comes out. So maybe three seconds over.

MR. HAUSER: Go right ahead.

MR. MASON: No, I'm done.

MR. HAUSER: You're done?

MR. MASON: That was my finale.

(Laughter.)

MR. HAUSER: All right. It was a nice flourish.

MR. MASON: Yeah, I have a feeling you'll have a flourish too.

(Laughter.)

MR. HAUSER: So, you know, first maybe let's start with some of the areas there appear to be agreement. You know, if I understand your comments, there is agreement, I forget the way you first put it, but it was something like, we are completely fine with the best interest standard. So we appear to have some degree of agreement that there should be a best interest standard on the broad contours of what that standard should look like and about what, I think what the carve-out should look like, and that we need a set of exemptions to permit, you know, people to move forward in a broker kind of model, as well as in an advice model. And those things we do seem to have a fair measure of agreement about.

Many of the areas of disagreement to me seem to be operational sorts of issues, precisely the sort of thing that should be worked out as part of a notice and comment process. So, you know, what should the timing of the contract be? Did you mean, as some have asserted, to exclude rollovers from the best interest contract exemption? The answer would be no and I don't think we did, but we'll certainly make that clear in the final. Do you cover one's touting their own services as fiduciary advice? No and if there's a drafting issue there, we'll make that clear.

There are all those kind of normal issues. But if one starts from the premise that, you know, that this isn't kind of a normal rulemaking process where we're going to get those kind of drafting issues sorted out and we're going to have an honest debate and this is the rule, it's final, and the only issue is whether or not the industry can comply with it exactly the way it is at this exact moment with no changes, you get to a different place perhaps.

So, we ultimately are very interested in figuring out how to fix any operational problems. We have a set of goals that we seem to have broad agreement on. We intend to listen to everybody who has given us comments. And believe me, I've made my way through a good part of those 5,000 pages of comments already. And, you know, if it turns out that we simply cannot make this thing workable without the sorts of major changes that necessitate, you know, new notice and comments, so be it. But I think to prejudge that we need a new notice and comment right now, you know, I just think it's premature.

But I'd like to go through a number of the assertions. First off when you say you're completely fine with the best interest standard, what do you mean? Is the best interest standard as we defined it, the prudence obligation coupled with the loyalty obligation as specified in our proposal, something you agree with?

MR. MASON: Do I get to ask questions about what you just said or not?

MR. HAUSER: You can volunteer observations.

(Laughter.)

MR. MASON: All right. I'm going to volunteer one and then I'll answer your question. I think clarifying -- you know, a lot of the things you're talking about changing would just be at the edges. I think a critical change that you did mention is to sort of to say that promoting your own services is not a fiduciary act. That would be a critical change. I think the timing of the contract and this and that, you know, I mean that's not going to change results. But that is a very -- that point you made I think is critical.

So sort of moving to your question, I mean, are you asking about the best interest as it's articulated in the BIC?

MR. HAUSER: Yes.

MR. MASON: Yeah. I mean, I think -- I have to say that I have talked to different people with different perspectives on that and I think there are a lot of people who are very concerned -- and you've heard this, I mean it's been raised several times -- that without regard language makes people nervous that they can't consider their own compensation. They're fine with putting the client first, but they are not fine with sort of just saying I'm not going to even think about like my compensation. So I think there are a number of people in the community who have that, you've heard that, and you've indicated that you are happy to address and to clarify that point and I think that would be a good thing.

MR. HAUSER: So maybe let's walk through just some of the observations you made. First, in terms of -- and again I guess, you know, I may look youthful, but I've been around quite awhile and I've been through enough projects at this point where, you know, I've heard that if I move forward with a particular proposal, the capital markets are going to collapse. Once I think I -- the third time I'd heard that on my first year on the job, I started to discount it a little bit. And believe me, I don't have that kind of power.

But when I hear that, you know, nobody in the industry is going to be able to comply with the rule --

MR. MASON: Nobody I spoke to.

MR. HAUSER: -- no one you spoke to, even as revised, I mean I have to wonder a little bit what people are being told, you know, what it is they're saying they're not going to be able to comply with.

For example, in your comment letter, you refer to a study by Greenwald and Associates, where Greenwald and Associates essentially, you know, did a survey, which indicated that, well, nobody was going to be able to, you know, comply with our rule and small businesses were, you know, going to stop sponsoring plans and the like. But you look at the lead-in to the survey and it describes the rule as "the Department of Labor is considering prohibiting both retirement plan providers and the advisors who sell retirement plans to employers from assisting the employers in the selection and monitoring of the funds in the retirement plan." Does that not seem a little slanted?

MR. MASON: Let me have two answers and I apologize for having two answers. But on this sort of sky is falling point, you know, I don't know, we can compare ages, but that wouldn't be all that fun. But I've been around a few years and I do remember as I talk to people about if you do this, the defined benefit plan is going to -- our system is going to continue in decline and there was all this, yeah, yeah, I've heard this sky is falling. I think those predictions have turned out to be very, very accurate. So I think that's one important point.

I was so carried away, what was your --

MR. HAUSER: My question is it seems to me --

MR. MASON: I got so passionate.

MR. HAUSER: I know, but it seems to me when people are telling me --

MR. MASON: Oh, yeah, dramatic, dramatic, yeah. Yeah, I got it.

MR. HAUSER: -- they're not going to be able to comply, you know, when people are given a survey that says the Department of Labor is considering prohibiting both retirement plan providers --

MR. MASON: That's exactly how I read the proposal.

MR. HAUSER: That's how you read it?

MR. MASON: Absolutely.

MR. HAUSER: And can you point to any language anywhere in the proposal that prohibits advisors from providing --

MR. MASON: Yes, absolutely, absolutely. When you provide assistance, in other words, I have -- I'm a service producer. I have 3,000 investment options. I go to that small business owner and the business owners says, look, I want to offer 10 or 15 to my employees and today I can provide education to that small business owner about what other similar small businesses have done in terms of lineup. Here's a conservative lineup. Here's a more aggressive. Here's a moderate lineup. Here are the differences. Here's how you can mix or match. Your decision, that's education in my mind. It's not fiduciary advice. Very clear under this proposal that's fiduciary advice and it would be a prohibited transaction because there is no exemption. So that description in the Greenwald Study, to me, is 100 percent correct.

MR. HAUSER: Okay.

MR. PIACENTINI: So the implication seems to be there that there's no way to provide fiduciary service to small businesses, that nobody is doing that or maybe the companies that you spoke to don't do that in the marketplace now.

MR. MASON: In terms of if you're doing -- the financial institutions that serve those markets today that I deal with, they are the sort of -- they're the record keepers and financial institutions that have an array of different funds that they offer, some are proprietary, some are non-proprietary, but have different amounts of revenue sharing that they pay. And in that context, it's basically a prohibition.

MR. PIACENTINI: Leave aside the proprietary for a minute, but there's no way to level, to rebate to the sponsor --

MR. MASON: I mean the only way to levelize is to eliminate your revenue stream because there may be some --

MR. PIACENTINI: -- to rebate the revenue?

MR. MASON: Well, yeah, but that's eliminating your entire stream.

MR. PIACENTINI: No, you keep the part that's a negotiated fee. That is an existing practice in the marketplace.

MR. MASON: Well, no, you'd levelize, you'd have to levelize. In other words, if I keep -- so the idea is if the different funds are paying me different amounts --

MR. PIACENTINI: Right.

MR. MASON: -- I read that as a prohibited transaction and so I'd have to rebate -- I'd have to establish sort of an amount that everybody pays me and any excess I'd have to rebate to the plan.

MR. HAUSER: So, Mr. Mason, I mean, I think this is just an example of my concern about this kind of talk about the likely impact of our rule. I mean the fact is, you know, there's a platform provider exception that's available for the small business person. Small business person could hire, you know, an adviser on a non-conflicted basis. There's a specific provision in the regulation for a variety of education that would be treated as non-fiduciary with respect to any platform that's being provided.

And in the SEP and SIMPLE IRA context, any advice to the individual IRA participant would be covered by the best interest contract exemption. And we specifically asked in the text of the rule whether the best interest contract exemption shouldn't be extended to the small sponsor.

You may think all of those things are inadequate to deliver advice. But to simply tell sponsors in a survey that, you know, the Department of Labor is thinking about prohibiting advice when it quite plainly is not what we're intending to

prohibit --

MR. MASON: It is. No, I guess I just don't accept that in the sense that you're saying that I can go to somebody with 3,000 options and say do it yourself, here's my platform of 3,000. That's not the real world. And you're also telling me I should go to --

MR. HAUSER: No. Mr. Mason, I did not tell you that.

MR. MASON: You can call me Kent.

(Laughter.)

MR. HAUSER: Well, Kent --

MR. MASON: You can yell at me now.

MR. HAUSER: -- I didn't tell you that. That's not what I said. I gave you a variety of mechanisms by which I think the advice can be delivered and also indicated, as is a fact, that we asked in the preamble whether the best interest contract exemption shouldn't be extended to small sponsors.

And it's just that you can kind of take this across the board. In every instance if you're going to adopt the very most unfavorable point of view from the perspective of your clients of what can be done here and if you're not going to acknowledge a willingness on the Department's part to fix operational issues and you're going to tell them that's what the rule is, that's that, and you comply or not isn't the answer --

MR. MASON: I'm just telling factually what the proposal does. I'm not --

MR. HAUSER: No, you're telling your interpretation of it and it's not even an interpretation that the Department of Labor agrees with.

MR. MASON: Well, I don't think that would be the standard. In other words, we are reading the proposal, okay. Once it leaves your hands, it is a proposal and sort of how you view it is not the issue. The issue is what does it say. And under it, under the proposal, there is an effective prohibition on exactly what I described.

MR. HAUSER: Okay. Well, I just disagree. But let's walk through some of the reasons why you think the best interest contract is unusable.

MR. MASON: Okay.

MR. HAUSER: And put aside everything else in the best interest contract exemption, I want to go piece by piece and you tell me which item as I go through them you think is going to be unusable for a broker.

MR. MASON: How are we doing on time?

MR. HAUSER: Let's start with a binding commitment, a binding up front commitment to act in your customer's best interest. We'll use the ERISA prudence and loyalty definition, so we'll take away that without regard to. Do you think the exemption is unusable if we ask brokers and their employing firms to do that much?

MR. MASON: To just have a sort of a unilateral contract, for example.

MR. HAUSER: Okay. We can do it by --

MR. MASON: An enforceable agreement.

MR. HAUSER: An enforceable agreement. That's --

MR. MASON: I mean, just -- I'll be very frank here, in terms of the financial institutions that I've talked to, there is a difference of opinion on that point. Some say they can live with that contract. Others say that contract poses far too much liability in terms of state law class action. So that's -- you know, all I can do is answer sort of as accurately as I can about the different views that I hear within the community.

MR. HAUSER: And what you're hearing from the community is even in just merely committing up front an enforceable manner to adhere to a best interest standard is enough to make people exit?

MR. MASON: No, that's not -- no, it's under a contract that can be enforced pursuant to state law class actions. In other words, committing to a best interest does not mean sort of having this contract. There are other ways to commit to a best interest without having a contract enforceable under state law class actions.

MR. HAUSER: And what would be the other enforceable ways?

MR. MASON: The simple way -- and again I'm saying there's different views within the community. I'm not trying to say, you know, everybody is on the same page on this like they are on most of the things I mentioned. But I think the alternative is to say this is a condition of the exemption. Acting in your best interest is a condition of the exemption. Now that's the alternative.

MR. HAUSER: And so sticking with the contract and this reluctance -- the possible exit from the market is true even if we retain the binding arbitration for individual claims? Just the possibility of class action claims is enough to let people run away?

MR. MASON: That is what I've heard from some companies, yes, absolutely. And, you know, as I say, that's not the universal view from the companies, but it is not an -- it's not by any means an insignificant portion and I don't have any great feel for sort of the size of the different groups.

MR. HAUSER: So it seems to me that, I mean, what that would be saying is that, you know, folks in this marketplace are prepared to tell their customers that they're adhering to a best interest standard and that they're acting in their customer's best interest, because that is what they do, but not if it's going to be enforceable by the customer.

MR. MASON: There's a lot of -- I think, as

I say, some are worried about state law class actions and are just being held up by those things, yes.

MR. HAUSER: And then I guess among the people you're talking to, if I go that extra step beyond just the best interest contract and I say, and you should also have policies and procedures to ensure, to reasonably ensure that people are going to comply with that and you don't incentivize people to violate the contract, does that pretty much put everybody out in your conversations?

MR. MASON: Is that a leading question?

MR. HAUSER: Yeah, I think it was.

MR. MASON: I think the answer here is -- the question is, you know, should you have incentives that cause you to violate the best interest? No. But I think the way it was sort of structured under the proposal was to say, you better have some darn good reasons not to have level pay at the advisor level and I do sense that there is very, very significant concern about that point.

You know, for example, and I think you're going to hear about this from some of my friends on the next panel, in the annuity context, you know, you did in the preamble sort of I think have an appropriate nod to the fact that some investments take more time and expertise to sell and that might justify a higher sort of fee at the advisory level. The problem is if you're risking a massive amount of legal liability, how do I determine sort of which -- you know, how to set that additional amount.

Nobody has a clue how to set that additional amount based on some nebulous concept of more time and expertise. So that risk of sort of just totally shooting in the dark as to what the differential could be is a huge problem, huge problem and really a deal killer for a lot of people.

And so do we have a problem sort of talking about, you know, don't have incentives to violate their best interest? Not a problem. But when you translate that into level fee at the advisory level with these squishy exceptions that really nobody would have any certainty they would meet, that's a problem. It's a big problem.

MR. HAUSER: Well, again, and this is part of how I think the notice and comment process is supposed to work, you know, we indicated in the preamble to the exemption certainly one way for a financial institution to comply is to adopt a level fee structure, but the exemption does not mandate such a structure. And then we go on later to say, you know, after giving these various examples, they're not exhaustive. Many other compensation and employment arrangements may satisfy the contractual warranties. The exemption imposes a broad standard for the warranty and policies and procedure requirement, not an inflexible and highly prescriptive set of rules. The financial institution retains the latitude necessary to design its compensation employment arrangements provided that those arrangements promote rather than undermine the best interest and in partial conduct standards.

That's clearly what was intended. We're clearly inviting comments and proposals from people on how to implement that. And if there are other examples -- if the five examples we gave, you know, aren't sufficient, we're asking people for additional guidance. There's not a level fee requirement in here.

MR. MASON: I think the point here is there's a safe -- I think the way it's read is that there's a safe harbor if you have a level fee and you stray outside that safe harbor at your own peril and people are not into their own peril. But I think the point that you're making about, you know, how can we work with you to create alternative, you know, ways to comply is a fair one and we should get back to you with answers on that point.

MR. HAUSER: With comments.

MR. MASON: Absolutely.

MR. HAUSER: With comment letters.

MR. MASON: Absolutely.

MR. HAUSER: That would be the -- that's the way we work with each other in this process. And I mean just continuing on with some of the other assertions and then, again, I mean if you think about it for a minute, I really wasn't trying to be flippant at the start. I mean I know that there are legitimate concerns out there about how to operationalize this and we're dead set on dealing with those concerns. But to come in and to say that nobody is going to do this and you know this for a fact because you've talked to all these folks, you know, the reality is if you agreed with our economic analysis, which I don't think you do, but if you agreed with it, if you thought we would right about it, you know, what we think is there is in excess of $17 billion a year transfer essentially going from, you know, from the investors to the financial services industry.

Now if you ask me how likely it is -- just knowing that fact, that the financial services industry is going to think a proposal that cuts into that is something they should endorse, I would think, well, probably they're not going to love it. And, you know, and similarly if my experience over the years has been any time we've proposed expanding someone's fiduciary duties, even if they're people who, you know, in all earnest think they're acting as fiduciaries, they tend to resist the imposition of liability. That's the natural order of things, you know. But it shouldn't be an indicator of whether or not we can get to a rule that we can all work with.

MR. MASON: And I'm not disagreeing that we can get to a rule. In other words, that's why I sort of went through sort of something which I think meets your objectives, but is a workable thing for the industry so that you don't have people losing access to information, which is what I think would happen. And, you know, with respect to Joe, I do, we would strongly, you know, for reasons articulated, we don't agree with the 17 billion.

MR. HAUSER: I thought that was true.

MR. MASON: I just figured, you know, why not.

MR. PIACENTINI: For the record that's the CEA's number, but we like those --

MR. MASON: No, I understand, I understand. No, I get it.

MR. HAUSER: And similarly there's -- and, again, I mean I would invite, you know, you in particular, but anybody else who wants to make comments, there's a number of points in your document here, you say, we would say even casual comments and casual conversations about investments would be picked up as fiduciary, when in fact, you know, we have a lengthy education provision that specifically provides that you can talk in detail about the specific investments, what their performance has been, their history --

MR. MASON: Can I give you a hypo? Can I give you a hypo?

MR. HAUSER: Well, can I just finish, please.

MR. MASON: Oh, absolutely, sorry.

MR. HAUSER: Thank you. You know, all of these things and the expense associated with the contract, the distribution options, all of the details of it, we specifically -- and this is additional, this is new in this proposal, we specifically include as education information, you know, about the advantages, you know, of keeping the money in the plan, about the retirement sorts of information. And we tried very hard to, you know, define the trigger for fiduciary advice in the first place in a way that's aligned with the FINRA standard, a recommendation, a call to action. That's not a casual conversation.

But I fear if that's what people are hearing from you, if that's what you're telling them, of course they're going to say, well, we don't like this rule. But it's not really what we've said here, is it?

MR. MASON: I mean first of all, there's sort of this thing, okay, they're hearing it from me. You're overstating sort of my effect by sort of thousandfold. You didn't get 5,000 pages of sort of comments because sort of I thought, well, gee, everybody, let's all comment on this proposal. You got 5,000 pages because there's a sort of an enormous level of concern. And in terms of sort of -- you know, I'd be very interested, and I'm saying this in all sincerity, because, you know, plan sponsor people call and say, you know, I look at this and I'm just thinking about our HR person and somebody wanders into the HR office and says, hey --

(Timer chimes.)

MR. MASON: Can I keep my hey going?

MR. HAUSER: Yes.

MR. MASON: Okay. So wanders into the HR office and says, look, I spent a lot of time on picking out my funds, can you just take a look at it. I don't really know what I'm doing, but does this look like what -- does this lineup look like something that I should be doing or am I just way off base. And the HR person says, look, I'm not an expert, but that's very similar to what other people, sort of similar situated people are doing.

That sounds like a suggestion, like this is okay about a very specific set of investment patterns and I don't see anything that carves that out --

MR. HAUSER: Yeah, there is.

MS. RITTENHOUSE: Yeah, there is.

MS. MCBRIDE: Yeah, there is.

MR. HAUSER: There's a specific provision on the HR --

MR. MASON: No, it is not. No, it doesn't.

MS. MCBRIDE: It's very specific.

MR. MASON: No, it doesn't. Actually that's wrong, that's wrong.

MR. HAUSER: So if you think --

MS. RITTENHOUSE: It's in there.

MR. MASON: No, it's not.

MS. MCBRIDE: If you read it, it's in there.

MR. MASON: No, it's advice to the fiduciary. This is advice to a participant, so that's wrong. I am right about this and I'll read it to you.

MR. HAUSER: No, Kent, Kent, it's fine. There are two ways in which what you're saying in incorrect. I mean, first off, again, this is an example, if you think we need to say more about that HR person and that limiting it to the fiduciary isn't enough, that's what the comment process is for.

But I'm going to say, the other thing as a general proposition is, you're not going to be adviser -- you have to be an adviser for a fee. There has to be a fee --

MR. MASON: HR people get paid. HR people get paid to help --

MS. MCBRIDE: Paid for that service.

MR. MASON: No, that's not true.

MS. MCBRIDE: No, it's in there.

MR. MASON: That's not true. That's not true.

MR. HAUSER: I mean, I can tell you, we would not construe that to be an investment --

MR. MASON: If you said that formally, that would make a huge difference.

MS. MCBRIDE: It's explicitly in there.

MR. MASON: It's not in there.

MS. MCBRIDE: It is.

(Laughter.)

MS. MCBRIDE: Sorry.

MR. HAUSER: But regardless, the point is there are all these different -- you know, there are bound to be a number of interpretive issues. But assuming that each one is going to go the worst way possible for your point of --

MR. MASON: I'm just --

MR. HAUSER: -- you know, view and -- well, I'll just leave it.

MR. PIACENTINI: So I know we're out of time. Let me just say that I was actually disappointed that you or somebody who worked on the different reports that you submitted didn't ask to testify at the part of the hearing on the economic analysis.

MR. MASON: Yeah.

MR. PIACENTINI: I do appreciate you bringing to the table, you know, your survey findings and so forth. You know, we welcome any and all kinds of input.

MR. MASON: Yeah. You know, that's a fair point, Joe. I mean --

MR. PIACENTINI: As you might expect, I do have questions I would have liked to ask about what's behind some of those findings, what some of the methods are. It would be helpful --

MR. MASON: I mean, if you would like to have follow-up, I mean, it really was sort of, you know, just a combination of sort of timing factors, et cetera, as opposed to any, you know, just working on -- the tight time sort of between all these things.

MR. PIACENTINI: Sure, understood.

MR. MASON: So I think it's a very fair point, Joe, and I would like to have the opportunity to sort of have that dialogue with you.

MR. PIACENTINI: And just to offer just one example, so you have a sense of the kind --

MR. MASON: Okay.

MR. PIACENTINI: -- of questions that will be on my mind. With respect to both small employers and whether they sponsor plans and individuals and how much they save, your reports reference a lot, that you tend to see that the presence of a financial advisor when you see plan sponsorship and greater savings, and it seems to attribute all of that to, well, the advisor's presence causes this. Of course we also have research that show that people who tend to save more, have more money are more than likely to see an advisor.

It didn't appear, although it didn't say for sure one way or the other, but it didn't appear that the report make any adjustment for that when it then tried to project what would happen if there was less access to advice. So that's the kind of question that I would want to ask.

MR. MASON: And we'd love to have that dialogue with you, Joe.

MR. PIACENTINI: Okay, all right. Thanks.

MR. HAUSER: Thank you all very much.

(Panel switch.)

MR. HAUSER: So this is the last panel of the day I think, yes? Okay. So we went a little over, but you can do likewise. So if you are all settled --

MR. HADLEY: Thanks so much for having us here. We're pleased to be here to testify regarding this important proposal. My name is Mike Hadley and here with me is my partner, Joe McKeever. We might as well get it out there, we are Kent's partners. Our firm represents the Committee of Annuity Insurers, a coalition of life insurance companies that was formed --

MR. HAUSER: That's not personal.

(Laughter.)

MR. HADLEY: I know it isn't and we appreciate that. The Coalition was formed in '81 to represent the interest of the annuity business and participate in the development of federal policy with respect to annuities, representing about 80 percent of the annuity business in the U.S.

The vast majority of savers in DC plans don't have access to a product that can generate guaranteed income in retirement and we strongly supported the efforts that you and the Treasury Department haven taken to try to increase the availability and use of annuities and plans. But for most participants, the only means to obtain guaranteed lifetime income is through a rollover into an IRA annuity. And if the proposal essentially prevents an agent, broker, or insurance company from being able to sell and explain an annuity without taking on fiduciary obligations and costs, annuities outside of plans would be less available and cost more when offered and that means less guaranteed income in retirement.

We certainly don't want to see this result and we really don't believe that you want to either. As a result, we want to work with you to ensure the important protections and guarantees that annuities provide will continue to be available to savers, while still achieving our shared goal of ensuring the financial professionals who provide investment advice act in the best interest of their clients.

Before I highlight some of the recommendations we made in our comment letter, to avoid unintended consequences, let me offer a few comments regarding annuities that are used in qualified plans and IRAs. And you heard some of this earlier, so apologies for me saying it again.

First, annuities are not simply investments. All annuities, both those that are securities and those that are not securities, provide insurance protection guarantees against longevity and other risks by allowing individuals to transfer those risks to an insurance company.

Second, while the cost of an annuity contract will often be greater than the cost of purchasing an indexed fund, those costs reflect the cost to the insurance company providing the benefits its guaranteed to its policyholders, benefits that often will not be paid until many years in the future.

And the costs reflect the time and effort that must be invested by someone in developing and understanding both the annuity product that they offer and the needs of the particular consumer with whom they're interacting.

Third, annuities and those who sell them are heavily regulated. We recognize there have been instances in which the purchase of an annuity has not turned out well for the purchaser. As an industry, we want to avoid any bad outcome involving an annuity contract. But such outcomes are no more common with annuities than with other investments.

For example, if you look at the types of securities involved in arbitration cases with FINRA in 2014, parties indicated annuities were involved in about 113 cases and variable annuities were involved in about 120 cases. In comparison, they indicated that mutual funds were involved in 378 cases and the various forms of individual stocks or bonds were involved in 716. Now we'd like that number to be zero obviously.

But we hear about these cases in no small part precisely because state insurance regulators and self-regulatory organizations like FINRA have procedures to protect customers. And so for the same reason we'd like you to never put out a press release about an enforcement action, those press releases are there because you're on the case.

Again, we don't think you intended to limit access to the guaranteed income that annuities provide, but we fear that without revisions the proposal will have that result. So I'm going to turn to discuss some of the recommendations we made in our comment later, although because of time constraints obviously I can't address every comment.

Let's start with the sellers carve-out. We agree with the Department's statement that the proposal should not cover incidental advice as part of an arm's-length transaction with no expectation of trust or acting in the customer's best interest. And so we strongly recommend that the sellers carve-out not be limited to fiduciaries of large plans, but rather be available in appropriate circumstances for discussions with all plan fiduciaries, participants, and IRA owners. And we understand your concern that in the context of a sale of an annuity, discussions about the sale should not presented as unbiased advice.

Now the sellers carve-out comes with very detailed conditions to ensure that there is no confusion that the person is acting as a seller and not providing unbiased advice. To take advantage of the sellers exception, you have to obtain a written representation the person will not rely on you to act in their best interest or as a fiduciary. You've got to inform the person of the existence and nature of any financial interest. You've got to receive a written representation the person had sufficient expertise to evaluate the transaction and to determine whether the transaction is prudent. And you can't receive a fee for providing investment advice. If those conditions are satisfied whether the person is a plan fiduciary, participant, or IRA owner, it's hard to see how any adult human being would be confused that they're expecting unbiased investment advice.

Let me now turn to PTE 84-24. We agree with the Department that a workable principle-based exemption is critical. We have a number of pretty serious concerns about BICE, which you've heard about, and which we detail in our comment letter. We'd be happy to answer any questions. And we have a straightforward solution that's consistent with the Department's goals.

PTE 84-24 should continue to be the exemption applicable to all annuities and other insurance projects. The notion of variable annuities are the same as mutual funds misunderstands that all annuities are designed to and in fact do provide insurance protection against longevity risk by pooling the risk among the large group of individuals so no single individual bears the risk alone. Annuities that are securities under the Federal Securities laws and those that are not all have advantages and disadvantages. None is inherently better than the other and none should be chose based on which PTE applies.

I do want to be clear, our concern about the distinction you've proposed between different types of annuities doesn't mean all annuities should be forced into the best interest contract exemption. For a variety of reasons, which you mentioned yourself in the preamble, the best interest contract exemption is not suited for annuities. Nonetheless, if you want to keep variable annuities and IRAs in the best interest contract exemption, this single exemption should consist of simplified conditions based on the straightforward and workable conditions in 84-24, as you've propose to amend.

So let me just say that again, if variable annuities remain in the best interest contract exemption, should be based on three straightforward and appropriate conditions that you've added to 84-24. The advisor acts in the client's best interest, the advisor makes no misleading statements regarding the products or its fees, and the advisor discloses their material conflicts of interest. Most of the other conditions in BICE are unnecessary, particularly in light of the existing regulatory structure and disclosures that are already required by the SEC and FINRA.

Our comment letter also makes some important recommendations for further changes to 84-24. For example, it's critical you confirm that 84-24 provides relief for the purchase of an insurance company's own product, if the insurance becomes a fiduciary and covers the compensation inherent in the contract itself. Second, that you expand the types of compensation beyond insurance commissions. Third, that you clarify that the best interest standard based -- that you've heard this discussion about the "without regard to."

Let me just talk a little bit about education focusing on the concerns we have for the sale of annuities -- the use of annuities, I'm sorry. When you're providing education to the owner of an

IRA annuity, somebody who already owns it, they're always going to have the option to annuitize their contract and they may have other options available under the contract. Those options have to be explained and the pros and cons of those also have to be explained and we appreciate your saying in these hearings that explaining the features of the product is still education.

Likewise, if a plan offers an annuity distribution option, that option has to be explained to the participant and we appreciate again what I think you've said that you didn't intend to cut that out of education. It's really not conceivable that you could be educated without mentioning the product, particularly a product you already own.

Let me close by making the self-evident point that no DOL regulation in a generation is more complex or affects more savers or more industry participants. We believe the industry is going to take -- they're going to need three years to implement the changes necessary and we strongly urge the Department to provide the proposal does not apply to annuities sold prior to the effective date of the regulation. This regulation obviously wasn't priced into the sale of that product.

Also, I want to reiterate that again what I've said a couple of times, we don't believe the Department intends to cut off access to guaranteed income. In fact, throughout this administration you've done a number of things to actually encourage that and I want to thank you again for those actions. We want to make sure that the current proposal does not contribute to the decline of retirement security that life annuity payments can provide, and we believe with some changes, to clarify the fiduciary test and to make those exemptions effective, we can meet our shared goal of helping Americans be more secure in their retirement.

Thanks and we'd be happy to take any of your questions.

MR. HAUSER: Thank you.

MR. MURPHY: Good afternoon. My name is Ed Murphy and I'm President of Empowerment Retirement. We're the second largest retirement recordkeeping in the United States with about seven-and-a-half million participants. And I appreciate the opportunity to testify. And I hope today to suggest some ways the proposed rule could be amended to promote greater clarity and remove some ambiguity.

I'd like to begin by sharing some results from our research efforts. Empower's research shows access to guidance makes a major positive contribution to reaching one's retirement goals. Each year our research and education army, Empower Institute, conducts a comprehensive survey of working Americans retirement readiness or what we call lifetime income score. It's basically defined as the participant's ability to replace varying percentages of their working income for life.

The survey takes account of projected Social Security benefits, home equity, even business ownership. It's very comprehensive. It further amasses the importance of multiple variables, such as access to workplace savings, home ownership, and levels of savings. We have consistently found that one of the most important such variables is access to professional investment advice. In fact the impact is dramatic. Working Americans who draw on professional financial advice regardless of their income levels are on track to replace 30 percent more of their working income for life than those who lack such advice. This suggests to us that any policy change that expands access to advice is positive and anything that inhibits access to advice risks undercutting working people's retirement future.

Our experience further shows that guidance is also invaluable when a workplace saver actually retires and needs to draw down their savings for income. Helping participants understand the distribution options available to them and the potential consequences of choosing among those options is critical in limiting the leakage of retirement savings.

For example, data from the plans that Empower record keeps shows an 18 percent decrease in participants who cash out their distributions when they're given the opportunity to speak with one of our call center representatives. Empower representatives field over four million calls a year -- that's 16,000 calls every working day -- and those workplace savers seek information on a range of issues, including roughly seven percent inquiring about investments in the plan's fund lineup, 26 percent asking for information on options for distribution, 22 percent asking for ways to access their savings while they're still working and contributing to their plans. Answering these requests is a major part of the value we deliver to plans and to workplace savers.

We are naturally concerned then about the scope and the breadth of the proposed rule definition of what constitutes advice. It would include any communication that based on content, context, and presentation might reasonably be viewed as a suggestion to engage or refrain from taking a particular course of action. We believe this is too broad. It could inadvertently cause many conversations regarding elements of a participant's plan to be deemed fiduciary advice including such generic information as the availability of managed accounts or the discussion of rollover options.

A more appropriate definition would limit the definition of fiduciary advice to active advocacy, to either take or refrain from taking a particular action. General information offered without active individualized advocacy to act or not act should be excluded from the definition of fiduciary advice.

We're also concerned that the proposal would include communication specifically directed to an individual. As mentioned earlier we have four million conversations a year. Each and every one of those conversations is specifically directed to the party on the other end of the phone. We also often provide targeted communications, to provide categories of plan participants.

For example, within the same plan a

participant who is 90 percent invested in employer stock, they may receive a flyer detailing the risk of over concentration in a specific security and the benefits of diversification. Another participant who has reached retirement age may receive a flyer detailing distribution strategies. Similarly, participants using our website are routinely prompted to see a next best step to help them reach their retirement goals. This may be a suggestion, for instance, to raise their savings rate or perhaps change their asset allocation.

Clearly, there should be no expectation of a fiduciary relationships in these categorical information notices, but the proposal could make sending such information a trigger for fiduciary status. To avoid inhibiting this routine information, we suggest that the Department revise any final rule to replace the term "specifically directed" with "individualized to the recipient."

The proposal does include a number of carve-outs to the rule, which we believe could be further improved. In the sellers carve-out, the Department excludes the definition arm's-length selling activities, but limits this carve-out to plans of either 100 or more participants or at least 100 million in plan assets. The fact is that in the small business market, the fiduciary is typically the company owner, who is experienced in both buying and selling services.

What's more, plan sponsors are fiduciaries regardless of their size. They're all subject to requirements of ERISA. The Department's concern with small employers lacking familiarity with the different compensation structures could be addressed by including a cigarette-style warning to the employer advising them of potential conflicts and directing them to the plan sponsor level fee disclosure required under Section 408(b)(2).

Both the platform and monitoring carve-outs should also be expanded. This rule should make clear that creating products in which a limited number of investment options are made available is not a fiduciary act, and some of these were covered in the last session. To avoid what otherwise would be an overwhelming array of choices, Empower and other platform providers narrow the universe of thousands of investment offerings to a manageable few based on factors specific to a market segment or to a group of plans. Such decisions about what investments to offer are not however individualized to any plans and so should not be considered as fiduciary acts.

The selection and monitoring carve-outs allows identifying investment alternatives that meet objective criteria set by the plan fiduciary. We request clarification that the service provider be permitted to assist a plan sponsor in shaping the criteria for investment options without triggering fiduciary responsibility.

In general, the education carve-out in the proposed rule should be expanded so that offering common planning tools does not become a fiduciary act. It's commonplace, for example, both in the enrollment process and in everyday interaction for web usage and call center interactions, to illustrate possible next steps for participants. We recommend these specific expansions to the education carve-out:

One, stipulate that providing calculators and modeling tools that include reference to specific funds in the plan lineup is not a fiduciary act.

Two, clarify that providing helpful information for participants to act upon that enhances retirement readiness is not a fiduciary activity.

Validate that providing instructions of alternate scenarios for participants to view as a means to encourage retirement savings is not a fiduciary act. This would include tools such as a lifetime income score or tools that compare participants with others in their peer group, so they can see how they're saving relative to peers.

We all ultimately want the same thing, a healthy retirement system that makes it easy for participants to succeed and reach their retirement dreams. At Empower, our clients are why we're in business. We take very seriously our commitments to the plans we serve and their participants. We all want to end up in the same place, but how we get there matters.

Thank you.

MR. HAUSER: Thank you. Mr. Bortz?

MR. BORTZ: Thank you. I'm Jason Bortz. I'm an attorney with the Capital Group. Capital is probably best known for the American Funds family of mutual funds.

The American Funds are only available to retail investors who work with a financial advisor, either a Registered Investment Adviser or a registered rep of a broker-dealer. And arguably the biggest change under this rule would be to make registered reps of broker-dealers into fiduciaries when they make investment-related recommendations to IRAs, right?

We really appreciate the proposed best interest contract exemption, the creation of a route to preserve the broker-dealer business model. We really believe that registered reps provide valuable financial advice and improve outcomes for savers. And we're broadly aligned on the best interest contract exemption you proposed. We support, like others, a best interest standard of conduct. We're also comfortable with up front disclosure, some right of recourse against an advisor who doesn't live up to the best interest standard, and some kind of conflicts mitigation, right? I think in broad brush strokes, there's some logic here, right, but it's really important to get the details right, right?

The top 30 financial intermediaries who we work with all have the capacity to do either commissionable business or fee-based advisory business. If you don't strike the balance just right, it's going to be much easier to do entirely and solely fee-based business and we're going to lose the valuable benefits you get from commissionable compensation structures. So we think you really need to get the details right or small balance investors are going to lose access to advice and other folks are going to end up paying more as they move to fee-based programs, right?

You've heard lots of suggestions from others about how to improve the best interest contract exemption. We're broadly aligned with a lot of those suggestions and kind of rather than going over this trod ground, I thought instead we'd talk a little bit about transition, right?

We're going to move from a current world of commissionable investments to a fiduciary world, right. How are we going to get there? How are we going to transition, right? And there are really one two options under the reg going forward for existing relationships and existing commissionable accounts. You either comply with the best interest contract or you shift the client to a fee-based advisory program. There's only two options.

Eight months to develop all of the procedural requirements and do everything that you need to comply with the best interest contract exemption, it's just not going to happen, right. It's not going to be a viable route for all of those existing accounts. You have to be ready to take a call from an existing investor who wants to know if they should hold in a downturn. Under this proposal you couldn't give them a hold recommendation unless you gotten the best interest contract exemption in place or you shifted to a fee-based program, right? So eight months, there's no way that's workable, right. We need more time for that to be a viable route to meaningfully preserve the broker-dealer business model.

And I think we suggest in our comment letter a phase-in of the requirements. You know, you could easily start with a best interest standard out of the gate and phase in these other requirements, whether it's the right of recourse, whether it's disclosure that may take a long time to build. This is pretty kind of novel sort of disclosure stuff that you all are talking about, so I think we need a phase-in of the requirements.

The other thing we're going to need is clear guidance about existing accounts, right, and there are really two aspects of existing accounts, right? One, even if you get the BIC, the best interest contract exemption, exactly right, you're still going to see the shift to fee-based accounts. Lots of commissionable accounts are still going to be moved to fee-based accounts. There will be firms that are just going to say, hey, from a business perspective, I don't want to run my advisory program through something the Department of Labor is calling a conflicted advice regime. I don't want to comply with this exemption. So we need guidance on what standard governs this shift from commissionable accounts to fee-based accounts.

So under the proposal, it will clearly be a fiduciary recommendation. The recommendation of my own fee-based program is fiduciary advice and you'd have to run it through the best interest contract exemption to deal with that conflict of interest, where you compare the revenue to the firm, the financial firm, under the commissionable program to the revenue under the fee-based program. You'd have to run it through that best interest contract exemption.

Now if you're going to move, as I think you've alluded to a couple of times now, away from treating the selling of your own advisory services as a fiduciary act, then you need to address how do I deal with a mixed selling of services and a sell recommendation on existing investments, right? So if you say, hey, move out of this commissionable account, come to this fee-based account, there's a mixed selling of services and a sell recommendation, which ordinarily would be contingent fiduciary recommendations, right? So we need a workable best interest contract exemption for those transitions, right. You don't want to lock people in to existing investments. There needs to be a way to move from existing commissionable accounts to new fee-based programs.

So if you think about the best interest contract exemption, it needs to cover services, right. The disclosure needs to work for a comparison of two service programs, right, instead of being asset focused. So you need to tailor it to this kind of a transition because it's going to happen.

The other thing we need is a grandfather rule for hold recommendations. You know, one of the core challenges here is you've got to comply with one of these two paths, best interest contract exemption or advisory, fee-based advisory, right. Lots of folks won't be able to get that done before they get that first call, that hold recommendation, right? And we think there are good policy reasons for grandfathering hold recommendations, right.

One is, there's really a continuation of advice that was given before the effective date of these rules, right? To retroactively impose the new rules, the entire best interest contract standard, on a hold recommendation is fundamentally to retroactively apply the rule.

Two, lots of people have prepaid for ongoing advice through a commission, right. The typical load mutual fund structure is an up front commission, followed by a 25 basis point or one-quarter of one percent 12b-1 fee out of the fund, right. They prepay through the commission on an economic basis and then all the advisor gets going forward is a quarter of one percent, right. You don't want to take away that economic benefit of the prepayment.

And the second last point is really they're only paying a quarter of a percent for ongoing advice, right. That's not the kind of conflict of interest that you really need to worry about in this rule, right. It's so small, nobody is going to recommend a hold on an existing commissionable mutual fund just to keep receiving a quarter of one percent on what are really small balance accounts, right.

So finally when you think about this, have other regulators done this? Yeah. The UK when the banned commissionable compensation really took this exact approach, right. First of all, they gave enormously detailed guidance on the transition, pages and pages of thought on the transition, because rules really, they fall off the tracks on transition. It's natural to spend all your time focused on the steady state rule in the future, but you really have to think about the transition and the UK grandfathered hold recommendations, allowed the ongoing receipt of trail commissions, and then they applied the full rules to sell recommendations, right.

So I think our biggest point is we need clarity on how this transition is going to work. And we think the rule we're suggesting is really pretty useful for lots of kinds of investments. You know, we come at this from the mutual fund perspective. We're a mutual fund company. But it also works for things like variable annuity contracts, which are typically sold with a commission, have ongoing fees out of the fund, and then typically have surrender charges. So we think hold recommendations on variable annuity contracts should similarly fall within this grandfather rule.

And the grandfather we're talking about is pretty narrow, right. It's not a relationship grandfather. It's not a grandfather for accounts. It's really just for the existing assets. It's not for new money, right. And we think over time this will kind of fade away organically, right. You'll see the new relationships migrate over time to fee based, where it makes sense because fee base can be a great solution for folks, right. And other folks will choose to maintain two accounts and over time those accounts will bleed away with ordinary turnover. So, we think it's a really healthy organic way to approach transition and we'd really encourage you to take a look at the UK model.

So, thank you.

MR. HAUSER: Thank you. I maybe just have one or two questions for a change. But just your point about grandfathering these arrangements, you know, we are looking very hard at how to reconfigure the grandfather provisions. A number of issues have been identified in connection with the grandfather provision, in addition to the one you've identified. But if in fact, you know, you've already essentially prepaid, you know, for the advice and for the investment and it's kind of a front load set of expenses, you know, I mean maybe on the one hand that's, that's -- and really we're now just talking about a small kind of trailing amount -- I mean, on the one hand maybe you're right, that that's a reason not to be too worried about the conflict, but on the other hand it also seems like it would be hard for somebody who is assigned a fiduciary responsibility to move somebody out of something where the cost were already essentially sunk costs and now we're just talking about those 25 basis points, if it's a good investment.

I just wonder if you have any thought about that. I mean, do you really need it to keep people in that investment?

MR. BORTZ: Yes. So I think what I hear you say is, hey, if the movement from a commissionable account to a fee-based program is itself a form of fiduciary investment advice that's conflicted and would need to run through a prohibited transaction exemption, do you need a grandfather; right?

MR. HAUSER: Right. If somebody advises you, you know, pull the money out of this existing investment that you've already -- and your fees at this point are -- if you disregard the stuff, it's already a sunk cost, are pretty small, I mean wouldn't it be hard for a fiduciary to justify that kind of advice in the first place? I mean how big is that risk?

MR. BORTZ: Yeah. I think that is fair. I guess what makes me pause is number one, under current law, I think the selling of your own advisory services isn't usually viewed as a fiduciary act. In fact there's a specific example that says selling your own fiduciary services even when you're already a fiduciary isn't fiduciary. So I think there's been that question about, hey, what standard will apply to sell recommendations. I think the other possibility is, hey, can I sell my advisory services without telling you what to do with your existing investments --

MR. HAUSER: I see.

MR. BORTZ: -- right. Can I bifurcate those two things?

MR. HAUSER: Right. Because I would think -- I mean on the first question, I mean it's one thing to tout yourself. It's another thing to advise somebody to take their money out of an existing investment. I mean that strikes me as investment advice.

MR. BORTZ: But you can bifurcate those two things and in that case you would want to know that you could give a hold on the existing investment without pulling in your advisory question, right. You're bifurcating the two questions, so advisory services versus the investment recommendation.

MR. HAUSER: I don't know. I'm not sure.

But on the other hand, maybe it's not worth -- maybe a broader grandfather provision just avoids me having to think too hard about that.

MR. BORTZ: I like that. You're tired. It's a long day.

(Laughter.)

MR. HAUSER: I'm just kidding. Go ahead.

MR. PIACENTINI: So I'd like to direct a question to Mr. Bortz. Just to make sure my understanding is right, we have a comment submitted for the record by Drs. Robert Litan and Hal Singer --

MR. BORTZ: Yeah.

MR. PIACENTINI: -- and that was caused by the Capital Group that we have that comment, right. And that comment is an analytic report on what some of the potential effects of our proposal might be. And so as I said to Mr. Mason in the previous panel, I would have very much welcomed an opportunity to talk about that at the other part of the hearing. So I won't do a lot of -- I won't address a lot of technical questions on that to you now, here, but just to say that, you know, I do have a number of questions about that report. And I'll just give you a couple of examples, so that you have a sense of the types of things that I would want to think through before I understood exactly how to take account of that as we go forward to a final analytic report of our own.

The one that I found the most puzzling I think is that the report asserts that we have no empirical evidence for our questioning that disclosure is unlikely to work, and they say we have only one experimental study. And I'm pretty sure I know what study they're referring to. There's an experimental study that we talk about in there. But we devote several pages to this topic and we cite a large volume of published academic literature and authoritative report from some years back by RAND for the SEC that found that people don't understand what kind of advisor they have, what the obligations of those advisors are. So it's just puzzling to me that that's missing.

A large part of the report tries to sort of pick apart our analysis, which makes sense, but does so a little bit on the back of an envelope, turning our 10-year aggregate numbers into a single basis point number. They appear to be using simple averages where a weighted average would have made more sense because the effects are actually different over those 10 years. So I'm not sure how to read their translation of what we did.

And then maybe just from one other example, they rely a lot on evidence from Vanguard. Without making reference to the fact that, as I understand it, Vanguard's advice program that they're talking about is a fiduciary advice program, that they tend to recommend that people invest in very low cost investments. In fact literature that we're looking at says other types of advisors often don't recommend exactly that. So it's hard to see the applicability.

And then they look at the results under target date funds as a proxy for what advisors do and they attribute a value to getting advice, broker advice, I guess, to how you would have done in a target date fund. And then they go on to separately quantify some value from rebalancing, which it seems to me would double count something that's already going on in that target date fund.

So -- I mean, those are just some examples, but there are a number of analytic questions I have about that report. So I'm really not sure yet how to take account of its findings in our ongoing work.

MR. BORTZ: Sure. So, I mean, thank you, Joe. And, you know, I'm not going to play arm chair economist -- I'm so out of my league -- but I'd be happy to try to connect you guys with Mr. Litan, Mr.

Singer, and, you know, hopefully you guys can sit down and talk it out and understand each other.

MR. PIACENTINI: Thank you.

MR. HAUSER: And Mr. Murphy, I just had a question about the asset allocation issue you identified in associating specific investment options on the fund menu with those allocations. We had a number of people suggest, the very first panel on this program, that one way to -- I think they agreed with you, that at least when it comes to a plan that has independent fiduciary oversight, the advantage to the participants of letting them populate that asset allocation outweighs, you know, the risk of it not being associated with the best interest standard in light of the other fiduciary being in that picture.

And what was suggested by a number of people was, well, if you just populated it with all of the relevant, you know, designated investment alternatives that match that asset allocation, that that should be good enough for us. Or maybe you populate all of those alternatives and have a provision that, and also the person making the asset allocation recommendation and doing the populating doesn't have, you know, a financial incentive. And I just wondered would that answer that objection for you?

MR. MURPHY: Yes.

MR. HAUSER: That would do the trick?

MR. MURPHY: That would work.

MR. HAUSER: Okay.

MR. MURPHY: Yeah. I think the challenge is that, you know, we have 450 billion in assets on our platform, but less than 10 percent is proprietary. So there's thousands of funds that are available. And I think this was the issue that came up in the last panel, it's that process of narrowing. And oftentimes we're asked to play a support role with the advisor in narrowing that lineup. And, you know, whether it's using something like a Morning Star nine style box, what we would want to make sure, particularly as it relates to these very, very small plans, is that we can continue to support that process. We don't frankly have any skin in the game other than trying to make sure that the right lineup is constructed for the plan sponsor, for the participants.

MR. HAUSER: Right. I mean I think it's -- you know, when we incorporated the education provisions --

MR. MURPHY: Yeah.

MR. HAUSER: -- you know, we really were intending to pick up, and I think we did, all of the original 96-1 education guidance, except that when it came to these asset allocations, as well as interactive models, if the advisor or consultant was tying those particular things to specific funds, that looked and felt like a recommendation to us. So I don't know -- but, you know, we weren't carving back any of the rest of the education provisions and, in fact, we expanded it a bit with additional retirement guidance.

But we'll go through your comments here and see whether there's additional clarity you need. I mean, would it have been the case that under the original 96-1 guidance too you'd have some anxiety

or --

MR. MURPHY: No.

MR. HAUSER: -- is it really this asset allocation issue is the big one?

MR. MURPHY: Yeah, I think it is the big one, yeah.

MR. HAUSER: Okay.

MR. MURPHY: Yeah.

MR. HAUSER: Thank you.

MR. CAMPAGNA: Mr. Murphy, on your suggestions as to the definition of recommendation, what we did is we looked at the FINRA definition and we used the call for action piece and we put that in the actual operative text. But if you look at our preamble, we basically quote the rest of how FINRA defines a recommendation; that is the closer you get to something individualized, the more likely it is to be a recommendation.

MR. MURPHY: Agreed.

MR. CAMPAGNA: I noticed that you said that you'd like a different kind of definition, more slanted towards an actual advocacy of a particular recommendation.

MR. MURPHY: I think it's probably semantics. I agree that it's individualized, is I think the right word to describe what we would view as a recommendation.

MR. HAUSER: So maybe you could help us there. You know, our anxiety generally about individualized isn't so much that we have an issue --

MR. MURPHY: Right.

MR. HAUSER: -- with that concept and we have no problem really with the general parameters of the FINRA guidance. It's that in this marketplace, that individualized has been one of the focuses -- foci I guess -- of disclaimers. You know, people -- I mean there will be all of this education, but there will also be essentially a specific product recommendation and nevertheless, you know, there'll be a statement in the materials that says, but it shouldn't be taken as individualized.

MR. MURPHY: Right. But let me just be clear, we're not in the business of giving advice. We don't give advice. So what we're referring to is our ability to communicate with participants and to support them on questions that they have on the plan. And our view is that the language is open to interpretation and it's somewhat ambiguous.

Now that might be our interpretation and our view. I think some of the comments that you made on the last panel, frankly, gave me a higher degree of comfort. But that's where we have concerns and questions. And I'll go back to my testimony when I talked about the four million calls that we take --

MR. HAUSER: Yes.

MR. MURPHY: -- and the call types, the specific things that we're being asked to do.

MR. HAUSER: So the FINRA -- you know, if you just think in terms of the FINRA test, it's intended to be sort of an objective standard based on, you know, what a reasonable person would have viewed as a call to action. But I would think in the context of four million calls, I mean you may well occasionally have somebody cross the line almost no matter where we draw that line, won't you? I mean isn't --

MR. MURPHY: I'm not sure. I mean first of all we monitor all calls. There's no incentive in terms of the representative's compensation to recommend or suggest something that wouldn't be in the best interest of the client. We're not giving specific mutual fund recommendations. We obviously don't give specific stock recommendations. So I mean I suppose, but I'm not sure how to quantify that or characterize that. I'm not sure how there would be a violation or what that violation would look like.

MR. HAUSER: Okay.

MR. MURPHY: Yeah.

MR. HAUSER: Okay. I mean so it would probably be helpful, I mean if you think about the specifics -- I mean you've outlined a number of your specific areas here, but if there are other specific circumstances that you think, you know, may well be encompassed by this plan level assistance, but you're not entirely sure about --

MR. MURPHY: Yes.

MR. HAUSER: -- it, you know, the more

detail the better for us --

MR. MURPHY: Excellent.

MR. HAUSER: -- in writing this.

MR. MURPHY: Great, thank you.

MR. CAMPAGNA: I'd follow up with that with the problems you're having with the phrase "specifically directed." You thought that that was a concern. Probably comments on that would be welcomed as well.

But there was an earlier example in some of the earlier panels. If you're in a roomful of people and you're saying -- you're pointing out specific people and without considering their individualized circumstances, you're saying that you should invest in a particular product. That is specifically directed and it seems to be along the lines of a recommendation without being individualized. So do you see a problem with that kind of scenario --

MR. MURPHY: I do.

MR. CAMPAGNA: -- that should be addressed as saying --

MR. MURPHY: I do. I do. I mean, I think, you know, I think anytime -- if I look at it in the context of the interactions that we have, the first thing we start with is what's available in the investment line up within the plan, what are the person's investment objectives, what are they trying to accomplish, and then we walk them through what the potential options would be within the context of their core lineup. So that's very different than the scenario that you just outlined.

MR. CAMPAGNA: Okay. I think there's been a question kind of thrown and I'll throw it out to all three of you. A lot of people have been talking about expansion of the seller's exception to cover all plans for all participants in IRAs, expansion of the education exception includes specific advice, and then tinkering and putting back this mutuality requirement. And the question that I had and the former panel member had is what have we gained? Isn't this just a new five-part test or a new version of the five-part test? And I just kind of think about your reaction to that.

I mean if you're selling a product, you're covered in any event. If you're providing specific recommendation, you can say that it's part of your education. And as long, you know, there's a concern over mutuality, which you can disclaim, we're kind of back where we started. So just the question for all of you.

MR. MURPHY: Well, I mean, I guess the way I think of it is I think the sellers carve-out, I think it should extend to all plans. I think that, you know, whether you're a business owner running a 10,000 employee business or a business owner running a 50 person business, you're a fiduciary under ERISA. And this is an area that we're really passionate about frankly because of the challenge we're facing in this country around the access gap and the fact we have 50 million Americans that work for small companies that aren't covered by workplace savings.

I'm not sure what we're trying to solve here. I know this year alone just in that space, we'll sell 3,000 plans through advisors, they all have an advisor attached to them, and the average size plan is 50 participants. And some use -- fee leveling is certainly available. You have advisors that are using fee-based pricing. But it tends to be a more commission-based market because plan sponsors found they don't want to write the check out of their corporate treasury. So they either charge the participants, which is disclosed on a monthly basis or a quarterly basis, or it's paid through 12b-1 fees.

But that's all disclosed. Every month we update on our website broker compensation, the services that the advisor is offering. Because you can't just look at the cost of the service, you have to look at it conjunction with the services that are being provided. We also break down in detail -- and this goes well beyond 408(b)(2), we break down in detail the revenue, the revenue that's retained by the asset manager and the revenue that's retained by the record keeper.

So I guess I just think of a small business owner as a fiduciary and it's important that the advisor community remains engaged in that space, if in fact we're going to solve the access gap. Because as you would expect, those plans typically are sold, they're not bought. So that's the way I think about this.

MR. HADLEY: If I could just sort of go back to your question, which is, you know, all these recommendations, are they just -- is it just going to put us back where we are? The first thing I would say is that the annuity industry that sells in the retirement market is not looking to put us back in the situation where people could just disclose out of conflicts and could disclose out of fiduciary status through a sentence. We definitely don't want to be in a position where somebody is acting in a way that a reasonable person would think would be acting in their best interest and providing investment advice.

I think all of the suggestions that you've been hearing have been about trying to get at, would a reasonable person think they're getting investment advice, right? And so making sure that things that are really education and not advice are covered, carved out, exception, whatever you want to call it, a circumstance where somebody really expects they're being sold a product and does not expect they're getting impartial advice, all of those at aimed at trying to get at what I think we all agree, you want a situation where there's -- if there's a reasonable expectation that this person is acting in your best interest, well, they're a fiduciary. Again, I don't think we're trying to sort of get back to the five-part test.

MR. BORTZ: I mean, I guess, Lou, the only thing I'd add is in some ways the reg swings from an extreme where it's easy to disclaim fiduciary status, to a regime where certain conversations which are obviously selling conversations are going to get pooled within the technical definition of fiduciary advice. And it's how do you kind of find that sweet spot in the middle.

I mean when we sell the American Funds, we're typically talking to a Registered Investment Adviser or a broker-dealer firm. There's no question that we're selling those funds. They're sophisticated counter parties. They're able to understand what's going on. That's all we offer, right?

But under this reg, I think under a literal reading, if that broker-dealer, their Registered Investment Advisor is a fiduciary to a plan, we're going to get thrown into fiduciary status in what's clearly a selling conversation. It's just important to find those situations where this ambiguity that's sort of driving, you know, a broader definition isn't present, you know, because there really is low hanging fruit where people clearly are selling.

MR. CAMPAGNA: And if you can indulge me, going into your comment letter --

MR. BORTZ: Yeah.

MR. CAMPAGNA: -- Mr. Bortz -- I'm speaking of the sellers exception, the concept of

wholesaling --

MR. BORTZ: Yeah.

MR. CAMPAGNA: -- you brought up and it struck me that that was kind of a new concept that maybe we haven't explored. And that's the idea that your sales force deals with these financial intermediaries that aren't really directly connected to -- they may manage plan assets, but they're not really directly connected to the plan or the plan participants.

Do you want to describe that a little bit? And you were asking for basically a tweak to the sellers exception, so --

MR. BORTZ: Yes.

MR. CAMPAGNA: So if you could explain that a little bit.

MR. BORTZ: So I think I mentioned this before, right, we really believe in the value of financial advice, so we really typically only deal with retail investors who are working with a financial advisor. So we direct our selling activity to other financial advisors, right, to registered broker-dealer firms, Registered Investment Advisors. And under this proposal if those folks are fiduciaries, 3(21) non-discretionary fiduciaries or 3(38) discretionary fiduciaries, and we make a recommendation, our wholesalers make a recommendation to that home office or to that individual advisor, I think under a literal reading of the reg, that would be fiduciary investment advice and we would have lot of prohibited transaction issues, right. We're only selling our own products.

It seems clear to me that those folks have the sophistication to know that it's a selling conversation, that they're not getting unbiased investment advice and sort of testing for their sophistication based on like how many assets do they manage, which you all have a little carve-out in the proposal. It's just going to be very awkward and often unworkable, right, is the test whether they exercise discretion over a certain threshold of assets. What do we do when they're new advisors? Is there an aggregation rule? Is it only plan assets that's under this test?

So, we think that's a simplified test where you look to whether the intermediary is a Registered Investment Adviser or registered broker-dealer. It makes a lot more sense and it's a natural selling exception.

MR. HADLEY: If I could just sort of build on that in the annuity space. One thing we haven't heard a lot about is terminal funding contracts, insurance contracts issued to largely terminating DB plans. This is another circumstance where we've got this problem that we can't sell the annuity. ERISA says when you terminate a plan, you've got to buy annuity contracts. You must buy them. Somebody has got to sell that. And in the context of marketing that, whether you're talking directly to a plan sponsor or to a consultant or advisor or somebody who's acting in the fiduciary capacity, we are not allowed to make any recommendation that our annuity may be -- recommend that annuity for that terminal funding situation.

But we think that those conversations could be very clear that we're talking about -- that it's a sales context. And if there are conditions that need to be put in place so that we can sell those to small plans or sell those to a fiduciary who doesn't literally manage assets, but is a consultant on DB plans, we need the carve-out. Again, we're only talking about a situation where it's clear from the facts and circumstances that no reasonable person would think they're getting impartial investment advice.

MR. CAMPAGNA: Would there be some kind of standard for these financial intermediaries that you guys could come up with or think about in the comment?

MR. HAUSER: Well, I understood you to say one.

MR. BORTZ: Yeah.

MR. HAUSER: Can I -- so, but on the terminating annuities, I mean that's kind of an interesting context and it raises an issue in my mind about maybe what sorts of things should be dealt with by exemption and what sorts of things should be dealt with by a definition. Because if you think about a terminating annuity purchase, I mean that's a purchase of -- that may be expenditure of all the assets of a defined benefit plan to cover, you know, all of the benefits that your employees are going to have for the rest of their life -- big, big decision. And if the recipient of that recommendation is somebody who isn't, you know -- doesn't have some level of expertise, you just wonder -- I mean what are we losing if we say that's not going to be a fiduciary communication?

MR. HADLEY: Well, the person that makes that decision is a fiduciary and you have detailed criteria they've got to go through. And I don't think we should assume in any of this that fiduciaries are violating law, in other words not having the expertise.

MR. HAUSER: No, no, but, you know, but the statute does -- I mean what the contemplates that advice to a plan, which operationally means advice to a fiduciary --

MR. HADLEY: Yeah.

MR. HAUSER: -- for a fee, that's fiduciary. I mean that's just the way the statute is written. So clearly, you know, a recommendation to a plan fiduciary is often picked up by the investment advice definition. And obviously we thought, well, we could bring some clarity for certain, you know, categories of recipients, you know, in circumstances where it seemed highly unlikely that anyone was doing this as anything other than kind of a counter party transaction. But I just wonder about -- I mean, gosh, if somebody is really looking to you to help them structure the purchase, pick the annuity, should we just -- I mean it seems like we need to exercise some care in just giving that a complete pass from the fiduciary role.

MR. HADLEY: Yeah. I'm not suggesting a complete pass. The sellers carve-out is there for a situation where a person understands that they're not getting impartial investment advice and you've got a bunch of criteria on that. And all we're saying is that when you're talking about any fiduciary, that if you have the conditions that you all put in, which to make sure that they don't think they're getting partial investment advice, that that should apply to any fiduciary.

MR. HAUSER: Okay, understood. All right. Well, thank you all very much for your time. Appreciate it. That's it for today. We'll see you at nine tomorrow.

(Whereupon, at 5:16 p.m., the hearing was adjourned, to reconvene on Thursday, August 13, 2015, at 9:00 a.m.)

REPORTER'S CERTIFICATE

CASE TITLE: Conflict of Interest Proposed Rule Meeting

HEARING DATE: August 12, 2015

LOCATION: Washington, D.C.

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

Date: August 12, 2015

Jen Metcalf
Official Reporter
Heritage Reporting Corporation
Suite 206
1220 L Street, N.W.
Washington, D.C. 20005-4018