TRANSCRIPT OF PROCEEDINGS

U.S. DEPARTMENT OF LABOR
EMPLOYEE BENEFITS SECURITY ADMINISTRATION

IN THE MATTER OF:)
)
CONFLICT OF INTEREST)
PROPOSED RULE, RELATED)
EXEMPTIONS AND REGULATORY)
IMPACT ANALYSIS HEARING)

Pages: 1047 through 1301

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UNITED STATES DEPARTMENT OF LABOR
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Main Auditorium
Frances Perkins Building
200 Constitution Avenue, N.W.
Washington, D.C.

Thursday,
August 13, 2015

The parties met, pursuant to the notice, at 9:00 a.m.

ATTENDEES:

Government Panel:

JUDY MARES
Deputy Assistant Secretary, EBSA

TIM HAUSER
Deputy Assistant Secretary for Program Operations,

CHRISTOPHER COSBY
Office of Policy and Research

JOE CANARY
Office of Regulations and Interpretations

LYSSA HALL
Office of Exemption Determinations

KAREN LLOYD
Office of Exemption Determinations

JOE PIACENTINI
Office of Policy and Research

LOU CAMPAGNA
Office of Regulations and Interpretations

ATTENDEES: (Cont'd)

Panel 21:

On Behalf of Ameriprise Financial:

THERESA M. SEYS, Vice President & Chief Counsel, Retail Retirement, Corporation Compensation & Benefits, General Counsel's Organization

On Behalf of Rebalance IRA:

SCOTT PURITZ, Managing Director

On Behalf of Stifel Financial Corp.:

RON KRUSZEWSKI, Chairman and Chief Executive Officer

Panel 22:

On Behalf of American Benefits Council:

LYNN DUDLEY, Senior Vice President, Global Retirement and Compensation Policy

On Behalf of American Society of Appraisers:

JEFFREY TARBELL, ASA

On Behalf of Financial Engines:

CHRISTOPHER JONES, Executive Vice President and Chief Investment Officer

Panel 23:

On Behalf of Alternative & Direct Investment Securities Association:

JOHN H. GRADY, Legislative and Regulatory Committee Chair, Chief Strategy and Risk Officer, RCS Capital

On Behalf of Investment Program Association:

MARK GOLDBERG, Chair Emeritus of the IPA, President, Investment Management, W.P. Carey Inc. and Chairman, Carey Financial, LLC

ATTENDEES: (Cont'd)

On Behalf of the Managed Funds Association:

STUART J. KASWELL, Executive Vice President & Managing Director, General Counsel
BEN ALLENSWORTH, Associate General Counsel

Panel 24:

On Behalf of Appraisal Institute:

SCOTT ROBINSON, President-Elect

On Behalf of Bond Dealers of America:

MICHAEL NICHOLAS, Chief Executive Officer

On Behalf of Franklin Square Capital Partners:

MIKE GERBER, Executive Vice President

Panel 25:

On Behalf of 3ethos:

DON TRONE, Founder and Chief Executive Officer

On Behalf of U.S. Securities Market Coalition:

GARY KATZ, Chief Executive Officer, International Securities Exchange

On Behalf of Weyn LLC:

IDA BYRD-HILL, Chief Executive Officer

On Behalf of Creative Investment Research, Inc. and National Crowdfunding Services, LLC:

WILLIAM M. CUNNINGHAM, Chief Executive Officer

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P R O C E E D I N G S

(9:00 a.m.)

MR. HAUSER: Okay. Welcome back to Camp ERISA. How many of you have been here all four days?

(Show of hands.)

MR. HAUSER: Well, stay in touch.

(Laughter.)

MR. HAUSER: I feel like we've grown to know each other. So we'll get started in just a moment, but let me just run through the usual kind of preliminaries. This is our public hearing on the conflict of interest rule. It's the fourth and last day of the hearings. It is being broadcast via streaming video which you can go to at www.dol.gov/live.

The hearing has been organized into 25 panels. I think we're still holding at 25, usually with three on a panel, sometimes four. We'll allow panelists 10 minutes to present their testimony. If you could try to stick to the 10 minutes, I'd very much appreciate it because we have a full agenda.

The basic plan is the panelists present their testimony and then the government panel members will be afforded an opportunity to ask questions. We won't accept questions from the audience today as yesterday and all the days before. We ask a lot of questions, but you really shouldn't infer any particular conclusions on our views or positions or where we're heading based on our having asked a question.

The hearing is being transcribed, so you will be able to read it and make comments on it. We're hoping that we'll be able to post it in about two weeks, and after that you would get another two weeks in which to make comments with the benefit of the transcript.

When you testify, if you could help us out by first just identifying yourself and the organization you're affiliated with. Again, stick to the 10 minutes, and please speak into the microphone so that we can get a complete and accurate transcript.

And I don't actually know when we're going to end today. We're going to end when the last witness has spoken. In the event of an emergency in the building, I'm hoping that will not happen, we've been lucky so far, but if there is one, an alarm will sound. There are two types of alarms. A long loud continuous tone means we will need to evacuate to an external assembly area outside the building. An intermittent tone followed by a public address announcement means that we will stay in the auditorium to shelter in place. If either alarm sounds, a man in yellow will jump up and help you. There they are.

Please do not plug laptops, phones, et cetera, into the sockets on the wall. We don't want anyone to trip or get hurt. And please make sure your cell phones are turned off and silenced. And now if you're ready we're ready.

MS. SEYS: Sure. Great. Thank you. Good morning. My name is Theresa Seys. I am Vice President and Chief Counsel for Ameriprise Financial, a diversified financial services company that has been helping individuals to save for and sustain a secure retirement for over 100 years. We have almost 10,000 advisors who work with retirement savers and retirees across the U.S.

I am tremendously proud of the work our financial advisors do to help our clients stay on track to reach their financial goals, whatever they may be: reducing debt, creating an emergency fund, purchasing a home, sending a son or daughter to college, and importantly, accumulating a retirement nest egg or creating a paycheck in retirement.

Ameriprise is the leader in financial planning. We have more certified financial planners than any other firm. All of our advisors are duly registered, which means that they can offer services on a commission basis or as a registered investment advisor on an advisory fee basis. We believe this flexibility is important because it allows our financial advisors to offer the products and services that are most appropriate for our clients. Ameriprise supports a uniform best interest standard across a client's entire portfolio.

We appreciate the Secretary's acknowledgement that the majority of advisors are doing the right thing and serving their clients' interests first. However, we believe the Department has not adequately accounted for the value financial advisors provide. Credible, well-researched studies, including one by Oliver Wyman that we helped sponsor, show that Americans who receive advice from a financial advisor have more assets overall and save more for retirement, and small business owners that work with advisors are much more likely to establish a retirement plan for themselves and their workers.

We understand that the Department intends to preserve the valuable advice and opportunities for guaranteed retirement income provided to retirement savers through commission-based products and accounts.

The sole relief the Department has left for commission-based accounts within IRAs is the best interest contract exemption.

While the Department and financial services industry may disagree on certain issues related to the proposal, we believe that the Department would agree that if the BIC exemption is not workable then advisors will no longer be able to recommend most products on a commission basis. Therefore, if the rule is to truly be business model neutral and not put a beneficial model at a disadvantage, it is imperative there be no doubt that the exemptive relief can be operationalized in a manner that permits advisors to continue to provide valuable, efficient, and cost-effective assistance to clients.

Over the past few days you've heard a great deal of testimony on why and how the definition itself is too broad, the carve-outs are too narrow, and the BIC exemption is not a viable solution. Ameriprise believes you can achieve a best interest standard for advice provided to 401(k) plan participants, IRA, and small business owners, and do so in a way that does not hamper financial advisors who are trying to help those persons achieve and sustain a secure retirement.

We agree with the Department that financial advisors should be held to a best interest standard for recommendations made to retail retirement clients. Compensation should be reasonable, and the client should receive disclosure on fees they could pay based on product or service recommendation and potential conflicts. In its current form, the BIC exemption is not the right vehicle for delivering this result. It only addresses one portion of a client's investment portfolio and comes with unnecessary, impracticable, and risk-laden conditions that do not benefit and in some instances may harm clients. You could transform the BIC exemption by using the following framework:

Require that there be a legally binding obligation to the client that the financial advisor and her firm will put that client's interests ahead of their own; in other words, act in the client's best interest.

Receive no more than reasonable compensation and provide simple, clear, and meaningful disclosure on the service and products offered to clients as well as any material conflicts. Such disclosure could leverage existing Department, SEC, and FINRA regulations.

Under this framework, the sole condition would be that this legally binding obligation be in place and covers the first recommendation made and any advice that follows. This obligation would apply to the initial recommendation, a rollover recommendation, whether it's a prospective client, new client, or long-tenured client. This framework would accomplish the goal of providing the 401(k) plan participant, small business owner, an IRA owner, a remedy to the extent she believes she has been harmed without introducing material risk that has a chilling effect on the provision of advice and without adding a litany of operational burdens that only make it more difficult to serve clients.

You would not need warranties that put into question whether firms can continue to recommend products on a commission basis or offer affiliated products. You would not need unprecedented disclosure and data request conditions that may be problematic to implement and where even an inadvertent error resulting in no harm to the client results in excise tax penalties.

This type of framework would truly provide a principles-based exemption that could accommodate and adapt to the broad range of evolving business practices. Any product or service recommended would need to be in the client's best interest. This provides firms and innovators the ability to offer and create a wide range of diverse products and services to meet ever-evolving and unique investor needs without sacrificing consumer protection. It also allows firms to build on client guides and current disclosures designed to meet existing Department, FINRA, and SEC disclosure regulations while ensuring that the client is informed about how much he could pay for a particular product or service. And an even better step forward would be a framework that would apply to both the taxable and tax advantaged portions of a client's portfolio in the form of a uniform fiduciary standard.

A nonqualified brokerage account holder, managed account client, IRA owner, small business owner, 401(k) plan participant, and annuitant could all be the same person.

Advice is holistic. People see all of their assets as available for planning, whether it be sending their children to college or saving for retirement. The Department should work with the SEC and FINRA to develop one standard that could truly benefit retirement savers and retirees.

We believe that the changes we have outlined meet the standard that the Secretary has indicated he supports, an enforceable best interest standard. As currently drafted, the potential liability under the BIC exemption for a breach of fiduciary duty with respect to IRAs is higher than for breach of fiduciary duty under ERISA. Congress decided that if there is a breach under ERISA there's a private right of action but no excise taxes, and for IRAs you have excise taxes but no private right of action.

The Department's proposal introduces both, making the potential risk for providing advice to IRAs higher than providing advice to ERISA plans. Furthermore, the Department must also provide for a sufficient time to implement this or any new framework. The initial proposal providing for an eight-month implementation period is inadequate. Firms should be afforded the time to build the necessary technology systems and client-facing tools to appropriately comply, and eight months is simply not feasible.

Also, there are still many questions to be addressed and issues that will need to be resolved prior to a final rule being published. We believe it is critical that the Department provide for an additional opportunity for the public to review and comment prior to finalizing the rule.

Thank you for the opportunity to appear before you today, and I'm happy to take any questions.

MR. HAUSER: Thank you. Please.

MR. PURITZ: It's a privilege and a pleasure to be here with you this morning. I'm Scott Puritz, the co-founder and managing director of Rebalance IRA. My firm is a registered investment advisor with approximately $280 million of assets under management. We serve slightly over 500 clients.

Rebalance IRA is a relatively new national investment advisory firm that combines top quality retirement expert investment advisors with low-cost, highly diversified retirement portfolios for everyday Americans. Our firm's investment committee includes financial luminaries Professor Burton Malkeil from Princeton; Dr. Charlie Ellis, who once chaired the investment committee of the famed Yale Endowment Fund; and Jay Vivian, who managed IBM's $100 billion plus corporate pension fund.

Rebalance IRA embraces a fiduciary legal standard of always bringing the interests of our clients' front and center. We provide retirement investment advice without commissions and without conflicts. This makes it very easy to embrace a fiduciary standard.

Rebalance IRA is part of a broad trend of investment advisory firms that seek to provide consumers with a fundamentally better set of retirement investment options. This new generation of firms is offering retirement investment advice to clients at all levels for very modest fees. Several of these firms provide excellent retirement investment management for small savers, with minimums starting as low as $250. This group of investment innovators includes new firms such as my own, Rebalance IRA, Wealthfront, Personal Capital, but also established players, such as Vanguard and Schwab.

This trend of retooling the financial services industry is about three years old and has met with considerable success in the marketplace. Tens of thousands of clients have switched over. The investment innovators are growing fast and collectively now manage over $15 billion of client assets. These investment innovators have three common features: they harness technology, they leverage new business models, and they deploy established, proven institutional grade investment portfolios.

The result for consumers is nothing short of extraordinary: lower costs, superior asset allocation, superior investment vehicles, which are not influenced by commissions, and superior transparency regarding costs.

At Rebalance IRA, our clients seek our help because they need advice about how to manage their retirement savings and how to understand the increasingly complex world of investment products. Our clients come to us from all walks of life: nurses, school teachers, plumbers, lawyers, doctors, professors, farmers, welders, government employees, regular Americans. We're in the marketplace every day dealing with everyday Americans as they struggle to find the best way to manage their investment savings. We see what is actually going on in the marketplace, and sometimes, frequently it's not a pretty sight.

I'd like to begin by telling a story of Mora, one of our clients and her experience with conflicted advice. Mora is a 37-year-old woman, married with three children. She's a very smart, very savvy individual. Mora is the type of woman, who is prudent and thoughtful in virtually everything she does, from planning a family vacation to negotiating a refinancing on the family's home.

In managing her family's retirement investments, Mora inherited a stockbroker from her father. She used this broker for a long time and believed that she was only paying the typical 1 percent investment fee, and Mora trusted this stockbroker with her family's retirement nest egg.

Mora was introduced to Rebalance IRA and reached out to learn more about our firm's services. Upon a review of her retirement investment savings we found that her broker had invested her retirement funds in actively managed mutual funds which contained a significant second level of fees. In addition, Mora's stockbroker had recommended a new actively managed mutual fund with a front-end load that took 5 percent right off the top.

When it was all said and done, Mora was paying over 2.3 percent in annual fees, not the typical 1 percent. What's worse, Mora had no idea what was going on, none, zero, zip. Her broker had never clearly disclosed the fund-level fees nor the fact that he did not have fiduciary responsibilities. In the end, Rebalance IRA was able to reduce the all-in costs for Mora's retirement accounts by nearly 70 percent or over $5,000 per year.

Albert Einstein is said to have described compound interest as the most powerful force in the universe, but long-term compounding is a double-edged sword. Fees also compound and unnecessarily eat away at retirement savings. In the case of our client, Mora, by the time she retires this extra $5,000 in annual fees would have compounded potentially to over half a million dollars of unnecessary fees, over half a million dollars of extra fees.

For many Americans this extra retirement investment fee burden is the difference between retirement investment security and having to take on a part-time job late in life. Unfortunately, Mora is not alone. One-third of the Rebalance IRA client base comes to our firm directly from having a suboptimal relationship with a brokerage firm. At our firm we refer to these clients as brokerage refugees.

The story we see, similar to Mora's, over and over again is all too familiar: a client at a brokerage firm who is stunned, absolutely stunned to find out that their trusted retirement investment advisor does not have a fiduciary obligation and equally stunned to find out that there is almost always a second layer of fees at the fund level.

The brokerage refugees that we see at our firm average 2.37 percent of total fees per year. Now this may not sound like a large amount of money, but over several decades this can eat up to one-third to one-half of a consumer's retirement nest egg, one-third to one-half. That's a big number.

When Rebalance IRA takes on these brokerage refugees as clients of our firm, we're able to immediately reduce the retirement investment fee structure by an average of 68 percent. We combine these real costs with a retirement investment plan, endowment style portfolios, systematic rebalancing which reduces risk, and finally a highly qualified two-person retirement investment team for every client, high tech plus high touch.

American inventiveness and the entrepreneurial spirit are alive and well in the financial services industry, but for all consumers to reap the full benefit of this extraordinary, truly extraordinarily surge in innovation there needs to be first greater transparency; second, greater flow of information, especially regarding costs; and finally, a greater alignment of economic interests. We believe that a regulatory level playing field will dramatically accelerate the retooling of the financial services industry and provide everyday Americans with fundamentally cheaper and fundamentally better ways to save for retirement.

Americans struggling to save for a dignified retirement should no longer be subjected to the conflicts of interest that are draining their retirement investments, and if traditional brokerage firms cannot live by the simple fiduciary standard and refuse to serve modest savers, that's okay. It's really okay. Other financial firms who embrace a conflict free, client first approach stand ready to help all Americans at all income levels prepare for a secure retirement.

Thank you. And again I appreciate this opportunity to share our perspective and look forward to any questions and discussion.

MR. HAUSER: Thank you.

MR. KRUSZEWSKI: Good morning. As Chairman and Chief Executive Officer of Stifel Financial Corp., I appreciate the opportunity the Department of Labor has given me and other interested parties throughout the industry to comment on your new proposed rule. I have been CEO of Stifel since 1997, have 30 years of experience in the securities industry.

For those of you that don't know Stifel, we are a financial services holding company headquartered in St. Louis, Missouri. This year marks our company's 125th anniversary. The company's broker-dealer affiliates provide securities brokerage, investment banking, and related financial services to individual investors, professional money managers, businesses and municipalities. Stifel manages over $200 billion in client assets through over 2800 registered representatives in more than 340 branches in 45 states.

It is important to note that Stifel is a dual registrant, meaning that it does business as both a FINRA registered broker-dealer governed by the '34 Act, as well as an SEC registered investment advisor governed by the '40 Act. As such, we have no particular axe to grind as we support both a commission-based and fee-based business model.

Over the past 75 plus years, both the suitability standard espoused by the '34 Act and the fiduciary model underpinning the '40 Act have well served investors in capital formation critical to our economy.

As I will more fully discuss momentarily, if the DOL proposed rule results in IRAs being forced into fee-based advisory models, Stifel will increase its revenues. So, from a business perspective, a shift to fee-based is beneficial to Stifel but detrimental to our commission-based IRA clients which may be forced into a fee-based account.

I was encouraged when I read the preamble of your rule proposal where you stated the need to "preserve beneficial business models for delivery of investment advice, such as brokerage IRAs," and you sought to do so by separately proposing new exemptions. However -- and by now I am certain you are tired of hearing this -- the best interest contract exemption is so operationally complex and the cost of compliance, not to mention the regulatory and litigation risk, is so prohibitively high that the end result may be the elimination of a commission-based brokerage model for IRA accounts.

My fears are shared by many, including (8) prominent Democratic senators, members of the Senate Finance Committee who recently urged you to "critically examine the BIC exemption to ensure that it's operational". In addition, my own home state representatives, Senator McCaskill and Congresswoman Wagner, both expressed similar concerns on a bipartisan basis. The collective fear, which I share, is that if the exemption is not workable it will have an adverse effect on IRA investors.

Does it surprise me that the best interest contract exemption is so complex and difficult, if not impossible to implement? Actually no. The reason I say this, because I believe the rule is intended to eliminate the commission-based brokerage model.

Upon reviewing the materials put forth by the Department in support of these proposals I was struck by the bright line distinction drawn between conflicted advice supposedly pervasive throughout the commission-based brokerage model and the conflict benefit -- conflict free benefits of the advisory model. The cost of conflicted advice cited by the DOL ranges from between \$2.5 billion and \$50 billion annually. Yet despite my training as a CPA I have no idea in reading the report how that was determined or how the range of costs could be so expansive.

We can debate whether or not the best interest exemption is unworkable. However, I believe there is no debate as to the increased, yes, increased cost to investors if in fact the commission-based brokerage model is effectively eliminated as an option for IRA accounts, especially small accounts. The increase in cost is easily measured by an increase in annual fees resulting from a shift to fee-based accounts and the estimated cost of losing investment advice.

First, what is the cost of switching from a brokerage IRA to a fee-based IRA? What I do know about the cost to investors is derived from the hard facts I gather from my position as Chairman and CEO of Stifel. Allow me to share some facts.

Within the IRA marketplace Stifel operates both an advisory-based and a self-directed brokerage model. We have over 330,000 IRA accounts with assets of over $47 billion. The vast majority of these accounts, approximately 81 percent, are commission-based brokerage accounts.

Stifel's experience is not unique, with the vast majority of IRA accounts held at financial services firms being commission-based. This is particularly true for small retirement accounts. Ninety-eight percent of IRA accounts containing less than $25,000 in assets are held in commission-based brokerage accounts.

One would naturally assume based on the DOL's claim of "conflicted advice" that brokerage IRA accounts are being charged substantially more than advisory clients. I can tell you nothing is further from the truth. In Stifel's case, commission-based IRA accounts pay roughly half in commissions of what a typical advisory account pays in fees.

Let me reiterate. Half the cost. Simply, if we charged our brokerage accounts the same fee percentage as we did advisory accounts, the costs to our brokerage IRA accounts would increase by nearly $150 million annually. This is what I meant by the proposed rule potentially being financially beneficial to Stifel yet detrimental to my commission-based IRA holders.

These results were compared to five other regional firms and yielded similar results, indicating costs would double, totaling in excess of $2 billion annually. Extrapolating across the industry, the costs would be staggering. The reality is that the more expensive advisory accounts versus simple commission-based accounts will cost average IRA investors in the aggregate many billions of dollars more than they are paying now.

So I would pose a simple question. If brokerage advice is so conflicted, how is it that brokerage IRA accounts are charged half what is charged to the advisory accounts?

Furthermore, at the heart of the DOL proposal is the contention that commission-based accountholders face a conflict of interest that causes investment losses. When NERA looked at investment returns, the data showed no evidence that commission-based accounts underperform fee-based accounts. NERA's results are consistent with my own observations at Stifel.

In addition, the reality is that if brokerage accounts are not available millions of smaller investors will lose access to individualized investment advice due to their modest accounts not meeting most firms' minimum account size for advisory accounts. In 2011, the DOL estimated that consumers who invest without professional advice make investment errors that costs them collectively over $100 billion a year. These numbers will only go up if this proposal is enacted.

Ultimately the overriding question is whether "acting in your client's best interest" is defined by the fiduciary standard in the '40 Act or a more broad-based best interest standard which enhances disclosures and supports both a commission-based brokerage model and a fee-based advisory model. I would note that this is exactly what FINRA has proposed.

Without question, both business models are viable options which provide investors flexibility and choice as to the method which they want to be serviced, and both options should remain available for investors.

In light of everything I've talked about today and all that has been said by the many industry representatives that have preceded me, my best unconflicted advice to investors saving for retirement would be as follows:

If the size, complexity, and volume of trading activity in your retirement account warrant it, avail yourself to a fee-based advisory account that offers the ongoing service that meets your investment needs. If, however, you are a buy-and-hold investor who wants to make your own investment choices with the benefit of financial advice, I would urge you to keep your pay-as-you-go brokerage commissioned IRA. These long-term investors are best served by their current brokerage accounts and should not be forced into more expensive advisory accounts.

As an alternative to the rules proposed by the Department Stifel supports the adoption of a uniform best interest standard as proposed by FINRA's CEO, Richard Ketchum. Specifically, Stifel believes that a universal best interest standard would best serve its clients' interest. We believe that a single standard applicable to all nonadvisory accounts, be they investment accounts or self-directed retirement accounts, is the only approach that makes sense for both clients and the firms that service them.

We believe that a universal best interest standard is the only viable approach because at Stifel, as with most brokerage firms, our clients maintain different types of accounts, both retirement and brokerage, within the same portfolio. These accounts are almost always handled by the same person. To have those accounts held at different standards with different limitations on investment choices is confusing to clients and fails to protect them in any meaningful way.

The DOL's proposal is to be commended for highlighting the need to ensure that retirement investors can obtain financial advice without fear of being subjected to abusive sales practices occasioned by inherent conflicts of interest, which I know can occur in both brokerage and fee-based models. However, the proposal is flawed and in conflict with existing rules and regulations, burdensome and so expensive to implement it will have an unintended consequence of causing many small investors to lose the benefit of services of an investment advisor altogether.

IRA brokerage accounts which are moved to advisor accounts will forced to pay fees well in excess of the commissions they currently pay. I would urge you to reconsider this overly complex proposal. Instead, Stifel supports, as I've said, a best interest standard which harmonizes the rules pertaining to all brokerage accounts, whether governed by the '34 Act or the '40 Act.

This solution will preserve investor choice, eliminate confusion, and provide a cost-effective means for investors, particularly small investors, to save for their retirement. This matter is of the utmost importance to investors and as such we should all work together to encourage the greatest number of people to save the most they can for their retirement. Limiting choice and increasing cost is not the way to do so. Thank you for your consideration.

MR. HAUSER: Thank you.

So, and I apologize, but I didn't catch your name at the start. Did you say it?

MR. KRUSZEWSKI: Yes. Ron Kruszewski.

MR. HAUSER: Mr. Kruszewski, I just have a couple questions. Probably I'm just worn out from the previous three days.

MR. KRUSZEWSKI: Understood.

MR. HAUSER: But, you know, first I can assure you I appreciate your statement at the start, but it is not our intention to eliminate broker-based accounts, nor is the rule intended to create any particular bias against those arrangements as long as they can adhere to, you know, what we think are some fundamental principles. And so I guess I'd just like to explore a little bit of this workability issue and maybe ask you just to take off the table the entirety of our best interest contract exemption and start from scratch. And I'll ask you about a few features that I think would be part of a simple best interest contract and you tell me if you think they're workable. And if you think they're not workable, tell me why they're not workable.

The first is a commitment, an up-front commitment to your customer, which could be made at the time money is actually transferred say, as long as it's retroactive to when the advice was given, but an up-front commitment those recommendations will have been made in the customer's best interest in the sense that the advice will have been prudent and will put the customer's interests first. Would that create a workability problem?

MR. KRUSZEWSKI: I think we do that today, so, you know, the devil is in the details when you say, you know, a contract or something, but the suitability standard and what we do for 125 years, we've been doing that, so that should be and is workable.

MR. HAUSER: Right, but I guess I'm not asking about the suitability standard, but whether, you know, a commitment that when your brokers, when your reps are giving advice to people, that that advice isn't going to be affected by their financial incentives but just going to be what's in the interest of the customer.

MR. KRUSZEWSKI: Again, I believe that that's what occurs today.

MR. HAUSER: Okay. And then similarly, if we add as a condition to that that you agree that your fees will be reasonable in relationship to the services you render to the customer, I mean, would there be any workability problem with that?

MR. KRUSZEWSKI: Again, I think the question is in reasonable. I think market determines reasonable. I note that my gentleman to the right, I looked at his fees and his account minimums and would note that our fees are reasonable compared to his, and so define reasonable in a reasonable manner, and, of course.

MR. HAUSER: Right. No, and we would view it that way. I mean, the market, it's essentially a market measure of what -- you know, it's always a question of what you're getting for what you're paying, but the governor on that's going to be a market sort of measure.

And then does it add -- does it make it unworkable for you to then, you know, make that commitment in a binding way to your customers so that they can enforce it, whether in FINRA proceedings, in individual claims or in a class action claim if they can actually meet the prerequisites of, you know, class action litigation?

MR. KRUSZEWSKI: Well, I think arbitration is alive and well in the securities industry, and clients often when they have a complaint will start with that you did not act in my best interest if that's what they say. I think the issue, though, is that what I recommend is a harmonized approach because it needs to be understood that the same client that you may be talking have a contract or all of the things you're talking about specifically for brokerage accounts often have multiple relationships at brokerage firms: taxable accounts, trading accounts, muni-bond accounts. They view their portfolios holistically, and to try to create a set of rules, a set of contracts or a set of standards for a slice of their investment is going to be extremely confusing and will have cross-effects on other accounts, and that is why this rule is in many ways unworkable. The average investor will not understand it.

MR. HAUSER: Well, does the average investor right now think that when they get advice from a Stifel rep that they're getting advice that's prudent and putting their interests first?

MR. KRUSZEWSKI: We've been in business for 125 years, all right, and if we had not been doing that we would not be in business. The market would assure us of our failure.

MR. HAUSER: Right, but I guess my point is so they're not going to -- your customer is not going to be confused by your adhering to that standard and having it be legally, you know, a binding legal obligation, are they? It's what they expect.

MR. KRUSZEWSKI: We have account agreements with our clients and I believe that the market works. I do. I don't believe that there is some obligation that needs to be contractually put down when the securities industry has been working fine for decades, decades.

So, look, a best interest standard, no one is going to argue against that, okay. We start by saying we put our client's interests first, all right, and I will tell you that is good business. It is smart business and we adhere to that standard. The real question is is the fiduciary standard as promulgated under the '40 Act applied to brokerage accounts in general is unworkable. It's been unworkable for decades and it would be unworkable tomorrow because of the nature of the capital formation, selection of investments, suitability versus prudent man standards make that unworkable. But an overriding best interest standard that applies to all accounts is something that should be done and that we would support absolutely.

MR. HAUSER: Okay. But I feel like I'm back to where we started. So, I mean, you think it's unworkable for a broker -- for a registered rep to actually just adhere to a standard of prudence and making recommendations that take only the customer's interests into account.

MR. KRUSZEWSKI: With all due respect, I don't think that's what I said. I said what is unworkable is to take a set of rules and apply it to a sliver of a client's investment portfolio without harmonizing those rules across the broad spectrum of investment. Our clients that this rule would impact on average have five other relationships at Stifel, different types of accounts that this purportedly would not impact. So that confusion is one where if we take a harmonized best interest standard and I believe in conjunction with FINRA and the SEC is the way to approach your objective.

MR. HAUSER: But this is essentially an argument that anything the Department of Labor does in this space is kind of by definition going to be unworkable, isn't it, at least unless and until the Securities and Exchange Commission and FINRA have changed the rules? I mean, you're saying if we impose a different standard that by definition is unworkable. Is that the argument?

MR. KRUSZEWSKI: No. I'm saying that I'll go back to my original comment, which is that it may not be the intention of the rule, but from my perspective, the application of the rule will eliminate self-commission-based brokerage accounts because it is unworkable across -- you can do that. That's exactly what you're doing. But when you do that you will eliminate the brokerage IRA.

MR. HAUSER: Okay. So, if we impose an obligation that was nothing more than a commitment, you know, up front before you've taken money from the customer that the recommendations you made and are going to make are going to be in your -- to the extent you continue to make recommendations, you can just have a one-time transaction, but the recommendation is going to be in your customer's best interest the way I described. It's going to be prudent and the fees are going to be reasonable in relationship to the services and even -- let's say that's it. You're telling me that's unworkable?

MR. KRUSZEWSKI: No.

MR. HAUSER: There's no particular complexity there, I don't think.

MR. KRUSZEWSKI: Well, there is, and I'll give you the complexity very simply, and you used the word "prudent". What is prudent for me may not be prudent for this gentleman. Under the '40 Act, prudence is defined by case law and a number of things where prudence has a very pretty clear standard as to what prudence is under ERISA. You're not going to buy generally unrated bonds, you can go on and on and on. But in most investment relations, prudence can be defined as what's prudent based upon an individual investor's objectives and the risk tolerance. So I agree --

MR. HAUSER: That's what ERISA prudence is as well. I mean, that's something I know a little bit about. ERISA prudence is -- first off, it's not a hindsight test, it's what's reasonable, you know, for, you know, it's essentially a reasonableness test, and it would be measured when you're talking about a plan or a participant in a plan or an IRA customer, it would be measured with respect to their risk tolerances, their goals, their retirement needs. It really would be the same sort of thing, and it wouldn't be a question of, you know, in hindsight, did the investment turn out poorly. It would strictly be a question of, you know, did you exercise reasonable judgment, did you follow a reasonable process in figuring out what to recommend in light of those considerations, and we could put more flesh on the bones if that would help.

But if we're talking about that kind of standard, would that create a workability problem?

MR. KRUSZEWSKI: Look, I would need to see it in details. I understand what you're saying, but I'd like to see the details. But I would like to say that I have many investors, sophisticated investors who believe in a brokerage account, whether it be an IRA or something else, that what they believe is prudent for them I may believe is risky, all right, and they often tell me that it's their money. And so that comes down to a question of who is defining prudence and --

MR. HAUSER: It's an objective -- the way it works is it's an objective test based on what, you know, a person familiar with such matters, a person with expertise in such matters, what kind of decision they would make. It's not a subjective sort of test at all. Does that comfort you at all?

MR. KRUSZEWSKI: Well, I would like to be able to use you as an expert witness because the litigation lawyers when I get sued under the standard, I can tell you that that's not what they say, but fair enough, so thank you.

(Laughter.)

MR. HAUSER: Well, you know, I plan on keeping my job.

(Laughter.)

MR. KRUSZEWSKI: Okay.

MR. HAUSER: Well, maybe I'll let somebody else go. I'm not really mulling over your offer, though.

(Laughter.)

MS. MARES: Actually, Mr. Puritz, I have a question for you.

MR. PURITZ: Sure.

MS. MARES: You made a comment that your customers use -- that you use endowment style portfolio management for your customers. Could you elaborate that for us, please?

MR. PURITZ: Sure. I mean, one thing I think is important to keep in mind is that in this industry, like other industries, technology is running through the industry and in the front end potentially transforming industry.

For the better part of 50 years the great endowments and pensions in the country have followed and the world have followed really a simple approach to investing top down. It's called modern portfolio theory with six to 10 different asset classes that are set up optimized for risk and reward tend to be medium and long-term in orientation, and it's very important to add disciplined rebalancing, which is primarily a risk management tool.

Until recently, until as recently as five years, it was really cost-prohibitive to provide that to small savers. But now, with the emergence of low-cost ETFs, computerized algorithms, much better ways to rebalance, you can have very small -- a $1,000 type starting IRA saver can have an endowment style portfolio that's almost as good as Yale's.

MS. MARES: So one of the things in my experience that endowment style portfolios have is very high concentration of illiquid investments. That's not what you're referring to here?

MR. PURITZ: I am not, no.

MS. MARES: Okay.

MR. PURITZ: No.

MS. MARES: So the investments within your clients' portfolios are all liquid investments?

MR. PURITZ: Correct. Yes, as are the other investment innovators, as are the Vanguard approach to this innovation.

MS. MARES: And you don't use the illiquid investments for some reason, and why don't you?

MR. PURITZ: Well, that is one area where it's hard to transfer the endowment style model down to small saving investors, and there's a lot of debate even within the pension world as to the cost/benefit of that, particularly for endowment pension funds that are not in the top 10 percent and can have access to the best funds.

MS. MARES: Thank you.

MR. PIACENTINI: Okay. I'd like to direct my first question to Mr. -- I'm going to do this wrong.

MR. KRUSZEWSKI: Kruszewski. That's all right.

MR. PIACENTINI: Kruszewski. Okay. I'm familiar with the problem, so thank you.

(Laughter.)

MR. PIACENTINI: So you made some -- part of your testimony was quantitative, and I'm the guy who does economic analysis for the regs, so I'm very interested in that part in particular. So let me start with you said that in your business the commission-based accounts, their expenses are half what they are in the fee-based accounts. Did I understand that correctly?

MR. KRUSZEWSKI: I think what I said was that the revenue charged by Stifel is half.

MR. PIACENTINI: Okay.

MR. KRUSZEWSKI: Okay.

MR. PIACENTINI: So also you mentioned along the way the NERA report, which we're familiar with, and there's a similar comparison across I guess a different sample of business in the NERA report, but in the NERA report they point out that their comparison doesn't include some of the indirect expenses, such as 12(b)(1) fees. They also said it doesn't include markups or markdowns I guess in principal transactions. So, when you're making that comparison, does that -- is it including all of those expenses in the two accounts, so, you know, sort of the total expense from the investor's perspective, or are there some things that are not included?

MR. KRUSZEWSKI: No. I mean, look, total return is total return. An account goes up or down in value inclusive of the expenses. So I'm looking at it holistically.

MR. PIACENTINI: Well, you made a comparison of returns, but I'm just asking right now specifically about the comparison of the expenses.

MR. KRUSZEWSKI: No. As it relates to expenses, what our Stifel brokerage IRAs on average, and I know people always like averages, but it's approximately 50 basis points per year is what we charge, and our advisory accounts is 107 basis points. So it's just simple math as to the difference in --

MR. PIACENTINI: And so I guess I'm asking what's included in the 50 basis points? Is that just the up-front commission? Does it include, for example, if there's a 12(b)(1) fee that produces a revenue stream back to Stifel, is that included in that?

MR. KRUSZEWSKI: Yes. Yes.

MR. PIACENTINI: So that's all inclusive of your --

MR. KRUSZEWSKI: Of Stifel's revenue that the advisor is sharing, and we pass all revenues to the advisors. So it does not include what the underlying, you know, ratios can be.

MR. PIACENTINI: So other expenses within the fund.

MR. KRUSZEWSKI: That's correct. Nor does our advisory account revenue include fees that may be charged, that may be paid to outside managers.

MR. PIACENTINI: Right. So do you have a sense of whether those expenses which are not included, because they're not paid to Stifel, are those higher in one or the other from the perspective of the investor? That is, do the fee-based advisors put people in lower expense funds or higher expense funds or the same?

MR. KRUSZEWSKI: Well, load funds, load funds will have --

MR. PIACENTINI: For example, there was a reference to ETFs.

MR. KRUSZEWSKI: Right.

MR. PIACENTINI: In either types of accounts are people put in low-cost ETFs or --

MR. KRUSZEWSKI: In advisory accounts you put in ETFs. I would say that in brokerage accounts generally not ETFs because people want to be paid for advice. I mean, there's nothing wrong -- this gentleman charges 50 basis points for advice. So the answer is is that at the simplest analysis, if we -- I want to go back to this, and I think it's lost in this whole debate. In a simple analysis, if we move our brokerage accounts supposedly to a non-conflicted advisory account, we will double what we charge them, and I think that that is lost in this entire discussion is that fact, and that fact extrapolated across the industry I have not seen in any study, and I know that it's real and large.

MR. PIACENTINI: I want to come back that and I want to ask all the panel, but let me ask one other question I wanted to direct specifically to you first. You referenced also the comparison of performance in the two different kinds of accounts, and there I think you started with a reference to the NERA reports.

MR. KRUSZEWSKI: Right.

MR. PIACENTINI: And they found there was no difference, and then you said that was your experience as well if I understood.

So we've looked at the NERA report and if I'm understanding the NERA report correctly, they report the returns in those different segments at the median, so they're telling us, you know, I think they've got some number of thousands of accounts they look at, and at the median what you don't see then is, you know, how the people who are doing better how much better they are doing, and the people who are doing worse. So I guess my first question is if you want to compare would you want to look beyond the median that's presented in the NERA report?

MR. KRUSZEWSKI: Whether -- you know, look, numbers are numbers.

MR. PIACENTINI: Yeah.

MR. KRUSZEWSKI: And you're a statistician, so I want to be careful before I wade into your thing here, but --

MR. PIACENTINI: You did say you're a CPA.

MR. KRUSZEWSKI: I did, I am a CPA, you know. I used to be. I don't like to admit that anymore. But the fact of the matter is I think that you need to take the tails off of both, okay? I think the tails of overperformance and underperformance can be analyzed in and of themselves. But medians and averages work, and my observations are that not just in IRA accounts but in general, that the broad averages and statistically that commission-based model and advisory-based models have very similar or really no statistical difference in performance in the aggregate.

MR. PIACENTINI: Okay.

MS. MARES: That's my observation.

MR. PIACENTINI: So the medians that are presented in the NERA report, they present them across a period of, I forget, 11 years or something like that, and there's a range, and in fact they find it across all those years on average the commission accounts outperformed a little bit, but they say it's not statistically significant.

But if you look across the years that they report, the differences from year to year in the medians are -- well, they range just to be specific from I think minus 1.93 percent, which is the commission accounts outperform by almost 2 percent in that year, to .63 percent, which is the advisory accounts outperformed by more than half a percent in that year. So I guess my question is NERA characterizes those differences in the report as small. Are those small differences? I'm wondering if you could explain why they would move around that much.

MR. KRUSZEWSKI: Right, right. Look, I don't think -- I don't want to be in a position to try to comment on a report that I didn't author.

MR. PIACENTINI: Sure.

MR. KRUSZEWSKI: Okay? And I would --

MR. PIACENTINI: But are they small? Is that a small difference?

MR. KRUSZEWSKI: Statistically speaking, I would characterize them as small. I think that what -- I think the point is is that there appears to be no basis. If there truly is a systemic problem in conflicted advice, you would see substantial change differences in the performance of brokerage models versus advisory models. If this was truly an issue which would require a national stage like this to deal with, those differences would be much greater than what NERA shows, and, frankly, my experience in 30 years in the business, I don't see that. That's the point I was making. If we want to get into whether 10 basis points is significant, I probably would have no comment. I don't understand. Significance means different things to different people.

MR. PIACENTINI: Understood. And I'm sorry if I put you on the spot. You referenced it in your report, so I thought I'd get maybe your opinion on it if you had one.

MR. KRUSZEWSKI: I'm often on the spot. I'm fine with that.

MR. PIACENTINI: Okay. So then coming back to this question of the movement, potential movement of some IRA accounts from brokerage to a fee-based account, and again, you know, reiterating that I think our intent is to preserve space for commission accounts, but in terms of that movement, maybe starting with this. So, if currently one costs twice as much or some amount more than the other, are they getting the same level of service or is the more expensive one getting more service?

MR. KRUSZEWSKI: You know, I would say that advisory accounts, in many cases, the advisor is directing investments that can be discretionary, rebalancing. They tend to trade more, which makes sense.

MR. PIACENTINI: So it sounds like the commission accounts might in fact be requiring less service, so that might be one of the reasons why they are being charged less.

MR. KRUSZEWSKI: Yeah. An example would be many, many IRAs just hold ladder bond portfolios, all right, and why would you need to pay 1 percent to watch your bonds mature? That doesn't make sense, okay?

MR. PIACENTINI: That is a perfect transition to my next question that I'd really like to invite anybody on the panel to comment on, which is if an investor with that sort of need and those sort of holdings is going to be served in one framework or another, would they necessarily be charged the much higher rate or might it be possible in a different model to serve them at a similar lower rate?

And as part of that, we heard in earlier testimony I think yesterday and the day before that we shouldn't be thinking just about traditional commission models and traditional asset-based fee models. There could also be hourly rates that might be paid in some instances. There could be flat fees that could be paid for some kinds of advice service.

MR. KRUSZEWSKI: I will just jump in since I've dominated this, but I would just say this, just one thing, I think this is important, okay?

To the extent that you put a bond account in a '40 Act scenario, okay, you're required to look at prudence, to look at things that are going on that otherwise the investor may choose themselves. So this is a question of is it the investor-directed account or is it an account that's directed by the advisor? And by doing and putting in your place you're going to force many firms, and I will tell you, I run a brokerage firm, if I'm tasked with either complying with the BIC or moving accounts to a brokerage, I'm not going to try to do the BIC for all the reasons I've stated, and that is why it's detrimental to investors. An advisory relationship under the '40 Act is different than a brokerage relationship under the '34 Act.

MR. PURITZ: Yeah, if I could jump in here. I mean, in all due respect, Ron, you know, our experience, your firm has 125 years experience, you have 30, but I will tell you in our experience with hundreds of clients that the marketplace is not working. It just categorically is not working. There is not true awareness of the multi-layer fees. We surveyed our clients who had come over from brokerage relationships and 83 percent of them had no idea of the second level of fees, and, it's, the averages that we see are between 2 and 3 percent all-in in terms of brokerage accounts in IRAs.

So I think part of the issue and the policy issue that is being debated is not what the last 20, 30 years was about but what's the next 30 to 100 years, and we do have several factors, including powerful technology that has the opportunity to serve consumers if there is a regulatory level playing field, and we're in an environment where clearly Professor Burton Malkiel on our investment committee and others have said a dramatically lower return environment where half a percent or a percent is going to make potentially a profound impact on return profiles over 10, 20, 30 years.

MR. KRUSZEWSKI: So, if I have a bond account that is a bond account with $200,000 in it, should I bring it to your account, to your firm? Yes or no?

MR. PURITZ: I mean, we don't do all bond accounts.

MR. KRUSZEWSKI: Of course you don't because the answer is no, because it would be unsuitable to take a bond account and put them through your fee-based model. That's a yes or no question.

MR. PURITZ: I'm not sure of the point you're trying to make.

MR. KRUSZEWSKI: Well, my point is that there are certain accounts the brokerage model is perfectly suitable for, and by the way, to the extent that you have accounts, I think you're a start-up business, and there are certainly accounts -- I'm not saying there are not accounts that are not charged excessive fees. I'm also saying there is advisory accounts that shouldn't be in advisory accounts either. But on the tail-end of both of this there's plenty of business models.

We're talking about millions and millions of investors that are adequately served in their current model, and to the extent that the market supports a business model like yours I'm all for you.

MR. PURITZ: How about a regulatory level playing field? What's wrong with that?

MR. KRUSZEWSKI: We have one.

MR. PURITZ: No, we don't. That's just absurd.

MR. PIACENTINI: Can you elaborate? What's not level about the playing field?

MR. PURITZ: You know, the complete different set of standards in terms -- you know, best interest is not a fiduciary standard. I mean, you know, there are -- we're not advocating for any wholesale reform other than it is essential that consumers know what they're buying, and they're not now. Whatever is going today in the marketplace we believe is just not working because -- you know, obviously we have a limited window, but it's statistically significant. You hear from others in the marketplace. Consumers in general, middle-class consumers are unaware of the fee structure they're playing, particularly in the second level of fees, at the fund level.

MR. PIACENTINI: So I'm going to lapse into a kind of a speak, just slightly say so. We have sort of an information problem, information cost, information asymmetry, right. Some of the information that's out there in the market, people aren't really using it, and that's making the playing field uneven, is that --

MR. PURITZ: Yeah. I mean, that's definitely the case. You know, part of baked into our core philosophy is full and fair disclosure, but also we have that legal obligation for full and fair disclosure, and we're just not seeing that out of the brokerage community. Our experience, you know, that's our limited experience, but it's very consistent over multiple years, over hundreds and hundreds of instances.

MR. KRUSZEWSKI: I think the market is a fair playing field. I'm on television here, so if all of my IRA investors want to look at your model where you charge 50 basis points, plus ETF fees, plus rebalancing fees, in many cases, that's higher than what we charge, they should give you a call. Okay?

MR. PURITZ: Okay.

MR. KRUSZEWSKI: And there's a level playing field for you.

MR. PURITZ: Thank you.

MS. SEYS: Well, it's my understanding that as a registered investment advisor under the fifth exemption --

MR. HAUSER: Could you pull the microphone? Thank you.

MS. SEYS: Oh, sure. Your firm wouldn't be subject to liability under state claim, right, I mean, and a broker-dealer would? So I think if we're talking a level playing field it might actually go the other way.

MR. PIACENTINI: So I have just one last question sort of on the numbers so to speak. So, Mr. Puritz, you said that, you know, you've encountered hundreds I guess of clients that have been paying total all-in fees at two levels at least of more than 2 percent. Can you unpack that a little bit? If you find somebody who's paying two and a half or something, what is that made up of? Where does that size of a total expense come from?

MR. PURITZ: Well, there is the, if you will, advisory piece of that or the wrap fee, and then --

MR. PIACENTINI: So I thought we were talking, though, about you're seeing brokerage clients who are paying, but now you're talking about an asset-based fee.

MR. PURITZ: Well, there's one level of fees that are disclosed, if you will, or the consumer seems to be aware of, you know, the classic 1 percent, percent and a half, or some differing configuration. But where there is almost always a lack of awareness is at the fund level where there are actively managed mutual funds that are typically frequently recommended, and that's the missing piece in the marketplace from our experience.

MR. PIACENTINI: Okay. So the examples you're talking about are individuals who are paying an asset-based fee and also paying at a high expense ratio for actively-managed funds are paying sort of both of those pieces? Is that where that example comes from?

MR. PURITZ: Frequently, yes.

MR. PIACENTINI: Okay.

MR. PURITZ: There's a variety of different ways you get to the 2 to 3 percent, but it's --

MR. PIACENTINI: Is there another one that you want to --

MR. PURITZ: No. I mean, no. I mean, it's so pervasive.

MR. PIACENTINI: Okay.

MR. CANARY: Okay. Thank you. Mr. Kruszewski, I'm sorry if I mispronounce that.

MR. PURITZ: You're popular.

MR. CANARY: But a couple of questions. You mentioned that some of your customers have five different types of accounts with you. Is it correct that those accounts are subject to different regulatory requirements? And just so I'm not like --

MR. KRUSZEWSKI: Right, right.

MR. CANARY: -- confusing you too much let me tell you where I'm headed with this.

MR. KRUSZEWSKI: Okay.

MR. CANARY: Which is I think what you were saying is you thought having an ERISA regulation on some of the accounts is going to generate confusion among your customers. And to the extent they already have five accounts and they're subject to different regulatory requirements, could you talk a little bit why you think having the ERISA structure added to that is going to create confusion where the current structure doesn't?

MR. KRUSZEWSKI: Well, I think that the basic, at the highest level again, the accounts fall either under the '34 Act or under the '40 Act and that we have clients that have both types of accounts: advisory, trading accounts, and a number of things. And the market has evolved and we are dual registrants, and I think that that works.

To take -- what becomes unworkable in the BIC standard is is the contract up front. The very -- this will sound ridiculous, but at some point you want to give advice on a taxable account and you need to look at your client and say, you know, you need to shut your IRA ear, okay, because I can't talk to your IRA ear, and if you come -- and the client comes back and said I liked buying X, Y, Z stock and I'm now going to buy it in my IRA, we're going to go, well, wait a minute, did I just miss the BIC exemption because I gave you some advice that I didn't mean to?

So the problem is is that the BIC exemption applied in our current environment. That's why it's unworkable. Today the '40 Act and the '34 Act are harmonious in brokerage firms.

MR. CANARY: Okay. So I wasn't really getting unworkable.

MR. KRUSZEWSKI: Okay.

MR. CANARY: I was getting confusion.

MR. KRUSZEWSKI: Okay.

MR. CANARY: So, in that conversation, where is the confusion? Because I would imagine that conversation you could say there are different rules that apply, and this advice I'm giving you because it's in the taxable space, not the ERISA space, and you should only be treating this as advice or guidance there because there are different rules that apply, much like if you were dealing with a registered investment advisor versus a brokerage.

MR. KRUSZEWSKI: Right.

MR. CANARY: You'd end up saying there are different rules that apply. So where's the confusion?

MR. KRUSZEWSKI: Well, the confusion, the confusion would be in the right in the middle of what I'm talking about, which is brokerage IRAs, all right, which are -- today there is no confusion in the '34 Act bond account, all right? But in a brokerage IRA where there isn't confusion, you would put in a huge amount of what I think are unworkable contract standard reporting where me running a firm will look at all of that and say you know what, I will eliminate that confusion and not offer the brokerage IRA, and I'm right back to where I was, at the '40 Act and I have the '34 Act. I don't have the sleeve in the middle, which is completely unworkable.

MR. CANARY: Do you want to --

MR. HAUSER: Well, I guess I'm just back to the confusion because now I'm confused, which is maybe part of my natural state. But, I mean, first off, is it the case that you tell your customers in the brokerage account as opposed to the advisory account that you're adhering to a different standard or don't you just essentially hold yourself as applying a best interest standard both times out?

MR. KRUSZEWSKI: No, we adhere to a best interest standard, of course.

MR. HAUSER: Right, and that's what you would do in the ERISA space as well. As far as your customer is concerned you'd be adhering to the same standard across the board because it would always be essentially a best interest standard. That's just how you work commercially, right?

MR. KRUSZEWSKI: Right, but I think --

MR. HAUSER: So where is the confusion in that?

MR. KRUSZEWSKI: The confusion is that you cannot take the best interest standard promulgated under the '40 Act today and apply it to '34 Act accounts. You can't do it. All right? You have fee-based accounts. You don't have principal-based. You have restriction of a number of things that apply in a '40 Act the clients choose and we adhere to.

To try to carve out what is otherwise a '34 Act brokerage account and create a whole 'nother set of standards setting right next to another '34 Act account is like creating three standards. And what firms will do is not do that because the costs of compliance litigation does not work, and from my perspective, it's really simple. Thank you very much. I'll just tell my clients I get to charge them more, and I'm going to move them into an advisory model. That is not in the best interest of clients even though it may be in the best interests of my firm.

MR. HAUSER: So if the prudence standard is, look, what would a reasonable investment professional have recommended in light of the particular circumstances of this customer, which is what the prudence standard is under ERISA. That's the standard we're talking about. Is that really different than the standard you hold yourself to with respect to a '40 Act account, a '34 Act account or any other account, or isn't that exactly the same standard that you right now adhere --

MR. KRUSZEWSKI: Exactly --

MR. HAUSER: -- that you would adhere to?

MR. KRUSZEWSKI: Exactly the same standard because --

MR. HAUSER: Right. So, again, so why is that a problem? I mean, when you launched into the workability objection this last time, you dragged in the notice provisions and the document retention and all that. But right now I'm just talking about suppose all there was was a promise that I'm going to act in -- I'm going to adhere to the best interest standard. I'm going to give you advice that's prudent, the fees are reasonable in relationship to the services, and this is enforceable. That's all there is, and it would be enforceable, by the way, both in the IRA space in whatever action is available there, and it would be enforceable in the ERISA context, in an ERISA action, but that would be it. What's unworkable about any of that?

MR. KRUSZEWSKI: There's nothing unworkable, and it should be enforceable in the '34 Act accounts. It should be a uniform, universal, best interest standard that umbrellas the entire brokerage relationship. And if I remember my testimony, that's exactly what I recommended that you do.

MR. HAUSER: Okay. So, as I said at the start of my question, quite possibly I'm confused. So, if you have all of that, I mean, I can't -- we don't have authority to say what happens in the non-retirement accounts. I mean, that's just outside of our purview. We do have, you know, authority when it comes to the retirement assets. That's the way our statute is structured. You know, we have the obligation to write the fiduciary rules when it comes to retirement accounts. We have the obligation to say what those standards are. That's built into the statutory structure.

You know, it might be that you would prefer that there would be one set of legal obligations that apply across the board, but Congress made a decision that when it comes to tax-preferred assets there would be a special regulatory regime and we're it.

And so the question that I have is if you're comfortable with prudent as I described it, you're comfortable with best interest as I described it, you don't have an issue with the contract, you know, as I described it, and the standards you hold yourself to in any case under the non-retirement assets, you know, under those accounts are the same as these, where is the confusion? What's the problem? Why doesn't that work for you? Because I'd like to make it work.

MR. KRUSZEWSKI: Well, look, you know, what you're saying should fit on three pieces of paper, okay? Three. You just said it in less than a minute. So, if you can say it in less than a minute, then we should write it simply, okay?

MR. HAUSER: Yes.

MR. KRUSZEWSKI: However, what you wrote I think is in 2500 pages with footnotes and this and this and this, and so it's not -- I don't think it's really fair to sit there and say would I agree with you on these very basic principle-based rules. I do. Let's just not make them 2800 pages of exceptions.

MR. HAUSER: So two, three things maybe there. One is I think I took longer than a minute.

(Laughter.)

MR. KRUSZEWSKI: I could write it in three pages, I promise you.

MR. HAUSER: But second is it's not -- I mean, people do love to take the picture of the stack of paper and have it bow tied and stuff, but the fact is the rule and the exemptions are this much. The rest of it is regulatory impact analysis and preamble. It really isn't that long and complex. So it's not thousands of pages that you're going to have to memorize or anything. But this is a notice and comment proceeding, and the truth is this is what we want to achieve. I mean, we do not want to make the broker model impossible.

We would agree with you that, you know, not everyone needs an ongoing advisory relationship, you know, or the kind of advisory relationship that is typically provided by an IRA. Some people need exactly the brokerage kind of relationship. We want to make that happen. We just want to tamp down the conflicts, and it's important to me.

If what you're telling me is the biggest problem with the exemption is all the bells and whistles that go with it, but you'd be okay with these fundamental principles, that tells me, okay, there's something there for us to do that can make this work for your firm. But if you're telling me that no, even if we just do those -- if we were to streamline it that way it still wouldn't work for you, that's a different thing.

MR. KRUSZEWSKI: I want to be clear here, all right? This is very important. This is not about working for my firm, okay?

MR. HAUSER: Yes.

MR. KRUSZEWSKI: Working for my firm, I am completely happy putting every one of my clients on a fee-based, okay? I told you it's hundreds of millions of dollars, and the industry will do that, and that cost needs to be done. I'm talking about investors, primarily small investors that need the ability to choice, and I would support what you're saying as long as a best interest standard does not buy us customers who want to be buy-and-hold investors and not be forced into a fee-based model.

It can be done with enhanced disclosures and any standard which encompasses both, that does what you want to do to tamp down conflicts and all of that. It's good for savings, it's good for a lot of things, and I would support that. Unfortunately, the rule as written does not accomplish that.

MR. HAUSER: You made that point and you can finish up.

MS. SEYS: I'd like to also address your question and I think if what you're saying is in your hypothetical you would have a best interest contract exemption where the requirements are the best interest standard and we can quibble over without regard to and other language and reasonable compensation. I definitely think that's a step in the right direction and something that we'd be very interested in taking a look at.

MR. HAUSER: Okay. So thank you very much for your time.

MR. CANARY: So, but --

MR. HAUSER: Sorry, we're not done.

MR. CANARY: Right. Sorry. I only have a little bit, so short for everyone.

I think I'm hearing from you, Ron, that a seller's exception is not critical to your business model, but could everyone talk about that? There's been a certain amount of commentary that we've gotten that says there needs to be circumstances where people can make things that amount to investment recommendations but in a sales environment. What do you think about that?

MS. SEYS: Sure, I'll go ahead. So, you know, I think consistent with some trades in our industry peers, you know, we do think the rule is overbroad and that it brings in traditional sales activities and makes them fiduciary activities.

However, as for our brokerage and IRA businesses for our specific business model, we have no issue with our financial advisors being held to a best interest standard for any discussion. So there I wouldn't try to rely on a sales carve-out or the education safe harbor because at some point the discussion is likely to turn to which products are available to fulfill the client's goals, and so I need a viable bright line exemption from the Department.

MR. HAUSER: And is the important thing in that regard where we draw the line on what counts as that recommendation, do you think, as opposed to a seller's carve-out? At what point does the communication kind of cross the line from, you know, sort of the counseling that doesn't really add up to a recommendation to not, or do you see it even differently than that?

MS. SEYS: I think I would see it differently than that. I think, as I said, at some point we're going to talk about products. I mean, we do --

MR. HAUSER: You just think that's a given.

MS. SEYS: I think it's something -- you know, we do have the option for clients and some choose them to just get a financial plan, pay for that, and they're free to take that plan and take it to any firm that they would like. But oftentimes they want to work with their advisor who has helped them develop that plan and they'll say, okay, you think that I should take X, Y, Z strategy. I agree with that. And what do you have for me? And so instead of trying to develop compliance and monitoring and supervision and surveillance for when was it sales, when was it education, and when did it turn into a recommendation where there was a call to action, I think why not just make the recommendation workable.

MR. HAUSER: Yeah, right.

MR. CANARY: Mr. Puritz, I don't know if --

MR. PURITZ: Yeah, I would say, you know, we're not in a position to opine on the specifics of the rule, but where we feel very comfortable talking is about what we see in the marketplace, and in our experience, very consistently the marketplace just isn't working. It's not working in terms of consumer awareness around costs, consumer awareness around conflicts, consumer awareness around sort of the fact that the individual in front of them or that institution is getting ongoing commissions, and that's a -- we see that as a pretty fundamental problem that needs to be addressed.

MR. CANARY: Thank you. Ron.

MR. KRUSZEWSKI: Look, I was told I wasn't even going to get any questions.

(Laughter.)

MR. KRUSZEWSKI: So I'm not going to -- I'm done.

(Laughter.)

MR. CANARY: I don't think you heard that from us.

MR. KRUSZEWSKI: No, my advisors are about to get an ear full.

(Laughter.)

MS. SEYS: You did a great job.

MR. HAUSER: Thank you all very much.

(Panel switch.)

MR. HAUSER: Good morning. So I never know what order we're supposed to go in. Do you have any preference on the panel? Alphabetical? Okay. Ms. Dudley.

MS. DUDLEY: Thank you very much.

Hi. Hi, everybody. I'm Lynn Dudley with the American Benefits Council. First of all, I'd like to start by thanking you all. I want to thank you not only for the opportunity to testify but the amazing ability to listen over the last four days and over the past few months and years that we've been working on this, and we think it's a really, really important topic, and we're here to help. We hope we're offering constructive comments. We appreciate your dedication. We know this is hard.

That being said, what I'd like to do today is, despite the many, many issues that we have talked about over the past few days, I want to share with you input that I've received from plan sponsors, directly from them over the past few months, and I hope it's helpful to you as you go back and look at the regulations.

The one overarching point we are hearing from large plan sponsors is that the redefinition seems to be at odds with employer efforts to facilitate employee engagement. Plan sponsors are trying to efficiently utilize both internal and external resources to enhance education and encourage more engagement with the plan. Plan sponsors around the country have noted, and it is all over the country that I've talked with them, have noted that they are concerned that the new rules will make many of the tools that they are using more difficult, more expensive, and may result in their having to pull back on those tools rather than encouraging more engagement through the use of them. I'd like to share a few examples of that if I might.

The impact on employee assistance is the most common issue that's raised with me. More specifically, they're concerned that the new rules as written currently will make sponsors and their providers, as one sponsor put it, unable to provide helpful responses and helpful information in many instances, and that's because they feel like the fiduciary advice standard is exceptionally easy to trigger and that the generic information permitted as education is either not going to be directly responsive or provides insufficient context to be useful to the participant.

A good example of this are call centers. Employers really very much value the helpful educational information exchange that goes on in call centers because employees tell them that they like the call centers. Many plan sponsors actually actively help shape the structure of their call centers to meet their participants' needs. Call centers often receive very basic questions from employees that are not very familiar with retirement programs. They may get questions where the employee is simply describing their situation or they may get questions about, you know, what do similarly situated employees invest in, or they may get questions about whether they should consider putting more money in one fund than another fund, why or why not.

Call centers today can provide some very basic information in an unbiased fashion, consistent with the direction of the plan sponsor without crossing the line, and employees value that information and it helps them engage in the plan, and we don't want to see the rule push us away from being able to do that.

Alternatively, an employee may already be in the plan and may call and ask about their existing investment decisions. They may ask about target date funds and age appropriateness. This is a very common question. They may ask if it's appropriate to invest in multiple -- this is a common thing too -- multiple target date funds and why wouldn't you do that. They may ask about brokerage windows or they may describe a social conscience issue and whether a brokerage window can solve that concern. They may ask about the employer's stock fund. Sometimes they don't exactly know the question they want to ask and you have to have the conversation to get the question, and it's a matter of helping them frame their question.

Under the proposal, sponsors are concerned that answers to those questions would be fiduciary advice and would make the call center a fiduciary, and that's true even when plan sponsors have a policy in place which is being followed and directs the call center representative to redirect the caller to an investment professional when they're asking for investment advice. Also, if it's being operated by a financial institution, they're concerned about the prohibited transaction rules. But very briefly, there are concerns that call centers would not be as effective as they are today.

Onsite briefings are another example of concerns that plan sponsors have. Currently, it's not uncommon for service providers to help out with onsite briefings. They cover enrollment contributions, investment loans, distributions, access to the tools, and other helpful questions. They don't want to see these sessions eliminated or have to be restructured and unable to have that conversation with employees.

Another example and one that you all have talked a lot about already and, you know, I don't plan to spend time on it today is really the interaction of HR employees, human resource employees, with other employees. I understand from the conversation that you don't mean to pick up the casual conversations, but we are concerned that human resources departments are called upon all the time to answer very basic questions for employees, and we don't want to see that source of information pulled back on in a way that people can't be helpful to plan participants.

In addition, we're concerned about the limitation on investment education. Under the 2015 proposal, providing examples of investments that fit within asset classes would be fiduciary advice. That would force education to be around theoretical conversations, and that may not be very helpful to plan participants. We think the end result would be that if our education materials are restricted that way we'll get more calls into our HR department to answer questions, and then they'll be frustrated because they can't answer the questions because of the narrow definition of what HR employees can really do.

Another concern that we have is oftentimes our large plans make investment advisory services available to provide additional help in managing plan participation. We're concerned that our frontline HR employees and our frontline call center reps won't be able to refer people to those advisory services because it's triggered too soon. The fiduciary liability is triggered too soon.

Very briefly, I'd like to talk about some solutions. We think it's very important that you all go back and clearly exclude casual conversations from the definition of fiduciary advice. We think it's also probably a very good idea to go back and look at the four consideration standard. Look at the possibility of adding back in there a mutual understanding of some sort so that that line of where you're triggering that fiduciary duty allows people to be responsive to the question that's being asked. And I realize that's hard to do, but we think it's really important. We'll try and help you as you go through that.

But the information that the recipient is receiving needs to play a significant role. It needs to reflect the considered judgment of the advisor. There are some elements we can work with you on to try to solve that problem, that gray area.

We also think safe harbor for co-fiduciary liability for the plan sponsor is very important where they have a clear policy, a clear written communicated policy that employees and service providers are prohibited from providing fiduciary advice and reasonably follow that policy and take steps when it's violated. Also a safe harbor, a similar safe harbor for plan sponsor employees who are not intentionally violating a policy, and again, education needs to be broadened out again a little bit.

And finally, we think it's very important that you really think seriously about a longer transition period. You're going to have a lot of operational issues for existing agreements, and you're going to have a lot of uncertainty. You know how this is when we have these major rule changes. It takes a long time to iron out the uncertainties, so we would urge you to take a little extra time there. Thank you.

MR. HAUSER: Thank you.

MR. JONES: My name is Christopher Jones, and I'm proud to serve as Chief Investment Officer and Executive Vice President of investment management for Financial Engines. Thank you for the opportunity to testify this morning.

As a third employee when I joined Financial Engines nearly 19 years ago, I've had the privilege to be part of the transformational impact of technology on the financial advisory industry. What once was only the wealthy could expect access to investment counsel from an independent fiduciary, now millions of

Americans, even those with modest balances, are able to enjoy the benefits of high-quality, conflict-free investment advice.

We applaud the Department's proposed rule to update the definition of fiduciary under ERISA. Since it was established in 1996, Financial Engines has provided advisory services in a fiduciary capacity to millions of plan participants in defined contribution plans. We believe the proposed rule is not only workable for providers of advisory services but will create substantial benefits and protections for recipients of those services, and we further believe the Department has provided adequate time for our industry to assess the rule and its requirements.

I'd like to spend my time today here focusing on four key points. First, now more than ever, individuals need unconflicted investment advice. Second, the proposed rule is workable for advisors and beneficial for investors. Third, the technology can facilitate advice to individuals regardless of wealth. And fourth, although we strongly support the proposed rule, there are a few areas where we believe it could be strengthened.

First, individuals need unconflicted investment advice. The American landscape, retirement landscape, has changed dramatically in the last few decades. There has never been a greater demand for high-quality investment advice. A recent Financial Engines study found, for example, that nearly seven out of 10 401(k) participants have portfolios with inappropriate risk and/or diversification.

However, current investment regulations crafted nearly 40 years ago allow advisors to operate with conflicts of interest that can result in great harm to investors. The status quo is no longer tenable given the immense stakes of our nation's shift to the defined contribution model for retirement savings.

Under current regulations, conflicted advisors can steer investors towards products that offer higher fees and commissions for the advisor, not towards what would be in the best interest or the best retirement outcome for the investor. Complex fee sharing arrangements, commission structures, and other conflicts create pressures to shade recommendations towards the interests of the advisor, such as steering investors away from low-cost 401(k) plans and into more expensive retail IRA accounts.

The vast majority of individual investors are entirely unaware that these conflicts exist. This makes them vulnerable to firms that claim to be on their side but eschew any fiduciary responsibility to act in the sole best interests of the client. As a result, many workers end up with investments that have lower returns and higher fees. Every day our nation's newspapers recount stories of individual investors being taken advantage of by unscrupulous advisors and the ingrained conflicts that permeate the retirement industry. It is time that investment regulations are updated to reflect this new reality facing retirement investors in America.

ERISA's fiduciary standards provide crucial protections against these conflicts. The proposed rule critically and necessarily applies these protections more broadly in light of a changing retirement landscape.

Second, based on our experience over the last two decades, we believe the proposed rule is entirely workable for financial advisors and beneficial for investors. Financial Engines is the leading provider of independent advisory services to large plan sponsors, working with more than 600 large employers, including 143 of the Fortune 500, and nine of the largest retirement plan providers serving the defined contribution market. We are the largest independent registered investment advisor in the United States. We offer advisory services to over

9.4 million participants in 401(k) and similar plans, and since 2010, Financial Engines has been a publicly traded company.

We assist individuals with developing a personalized and comprehensive savings, investing, and retirement income plan. So 401(k) plans are not devoid of retirement advice. Financial Engines can either professionally manage an employee's account on a discretionary basis with access to human advisors or provide online advice through expert recommendations and interactive tools.

Additionally, Financial Engines provides a retirement readiness assessment, including estimated annual retirement income from Social Security, 401(k)s, IRAs, and pensions, if applicable, to all employees in the plans we serve. With our income plus feature, participants can receive payouts that are designed to last for life with the purchase of an optional out-of-plan fixed annuity.

Participants can also use our services to generate an income plan which brings together all of the sources of retirement income with guidance on Social Security claiming strategies all at no additional fee.

We provide investment advisory services as a fiduciary under ERISA and under the parallel prohibited transaction restrictions of the Internal Revenue Code. We are also regulated by the SEC as a federally registered investment advisor. From the beginning we have carefully structured our business to ensure that we have no conflicts that would compromise the objectivity of our investment advice.

What does independence mean? It means we do not sell any investment products of any kind. We do not receive differential compensation or commissions on the investments that we recommend. We do not vary our investment methodology across our customers, nor do we play any role in the selection of a particular retirement plan's fund lineup.

In short, our experience demonstrates that it's possible to provide personalized unconflicted investment advice and produce solid business results even when compliance costs are factored in.

Third, technology can facilitate affordable, high-quality and objective investment advice to individuals regardless of their wealth. Technology has democratized the advice once only available to high net worth investors, dramatically increasing the accessibility and affordability.

Moreover, we are confident the proposed rule will further accelerate the trend towards low-cost technology-based financial services and products which will, in turn, make unconflicted advice increasingly cost-effective for both advisors and accessible for investors of all means.

Since 1996 when Financial Engines was first established by Noble Laureate William Sharpe, former SEC Commissioner Joseph Grundfest, and the late Craig Johnson, our vision has been to provide high-quality, independent investment advice to everyone regardless of their wealth or investment experience. Innovative and powerful technology has been at the core of our business, allowing us to provide services at unprecedented scale to individuals that may not otherwise have access to high-quality investment advice.

We model over 39,000 different securities while considering investment style, risk, tax implications, expenses, redemption fees, loads, and other distributions. As a result, over 3 million people have used Financial Engines' online advice and approximately 900,000 have their retirement account professionally managed by our company.

The median balance of our discretionary managed account clients is $57,000, and nearly 240,000 of our clients have less than $20,000 in their 401(k) portfolio. Of the more than 9 million plan participants with access to our services, the median balance is $32,000 in their account, and approximately 43 percent of these participants have less than $25,000 in their 401(k) portfolio.

We offer advisory services both through the web and through trained investment advisor representatives in our Phoenix and Boston call centers.

Fourth, although we strongly support the proposed rule, we urge the Department to address certain areas that may result in unintended consequences. Financial Engines' comment letter outlines certain areas of the proposed rule that could be strengthened. As the Department considers potential changes to the proposed rule, we urge you to weigh how each change will result in more investors getting access to unconflicted advice.

For example, the proposed rule may restrict the ability of advisors to present services to investors. In order to increase access to personalized, unconflicted investment advice, it is essential that investment advisors are able to communicate to investors information about their services.

The Department has also asked whether it is appropriate to omit provisions of IB 96-1 related to specific investment products and alternatives. We believe that the investment education carve-out is appropriate without including specific investment products and alternatives under the plan or IRA. However, we recognize that there may be circumstances in which the identification of specific products does not create a conflict. We suggest that the language be modified to allow the presentation of specific investment products if additional criteria are met.

In conclusion, on behalf of Financial Engines, I would like to thank you again for the opportunity to testify today. In our experience, there is simply no truth to the assertion that unconflicted advice costs more to provide than conflicted advice. Conflicted advice often makes it difficult for investors to understand what they are truly paying, and we strongly believe that all investors deserve a fiduciary standard of care, and we welcome the opportunity to work with the Department on these important issues. Thank you.

MR. HAUSER: Thank you.

Mr. Tarbell.

MR. TARBELL: Good morning. My name is Jeff Tarbell, and I'm testifying on behalf of the American Society of Appraisers. The ASA is a multi-disciplined nonprofit professional appraisal organization which teaches, tests, and credentials high quality appraisers of businesses and business interests, real estate, personal property, and machinery and equipment.

By way of personal background, I'm employed at Houlihan Lokey, an investment bank that, among other things, provides valuation and fairness opinion services related to ESOPs and other employee stock plans under ERISA. I have more than 25 years of experience performing such valuations and fairness opinions, many of them related to employee stock ownership plans. I'm an accredited senior appraiser with the ASA in business valuation and the past chair of the ESOP association's evaluation committee. I also hold a chartered financial analyst designation and a general securities license.

The ASA appreciates the opportunity to testify at today's hearing on EBSA's proposed conflict of interest rule. My testimony will be limited to the valuation provisions of the rule, most importantly, issues governing the fiduciary status of individuals who provide appraisals, fairness opinions, and other valuation services to ESOPs, IRAs, 401(k)s, and other plans under ERISA. Our written comments in response to the proposal were submitted several weeks ago.

To begin, the ASA greatly appreciates EBSA's decision to amend the 2010 proposal by removing from the current proposal's definition of fiduciary appraisals and fairness opinions of employer securities held by ESOPs. Such valuations are typically provided pursuant to ERISA reporting requirements and constitute the largest number of valuation engagements for ESOPs. Their exclusion from fiduciary status is a welcome development and a noteworthy example of EBSA's willingness to constructively consider and respond to stakeholder concerns.

We're hopeful that this same spirit of open-mindedness will continue because while the newly proposed regulation is a significant improvement over the 2010 proposal, we are still troubled by the fact that it continues to apply fiduciary status to an important category of valuation and fairness opinions, specifically, those involving the purchase, sale or exchange by ESOPs and other plans of all assets other than company securities.

While we are aware of no hard data on the number of these individual transactions and on the specific types of property purchased, sold or exchanged by plans, we do know they are a common occurrence that most often involve the valuation of real property or privately-held securities in the portfolio of non-ESOP ERISA plans. These transactions are important to plan participants and to the appraisers who value the assets involved.

ASA members and I would expect the entire community of professional appraisers strongly oppose what can be characterized as a carve-out from the carve-out in the proposed rule. We do not believe there is any reasonable public policy rationale that supports EBSA having two separate and distinct appraisal policies, one involving the valuation of employer securities held by ESOPs and another involving all other assets that a plan might purchase, sell or exchange. We believe EBSA should have one appraisal policy governing the valuation of plan assets.

Accordingly, we urge that the proposed rule be amended by excluding from the definition of fiduciary appraisals and fairness opinions not simply of ESOP securities but of all assets held by ESOPs and other ERISA plans and that EBSA continue with its efforts to address its valuation concerns in a separate initiative.

EBSA's decision not to exclude all property categories from appraisal fiduciary requirements resurrects the many substantive reasons ASA, the community of professional appraisers, and many ESOP-owned companies strongly oppose the appraisal provisions of the 2010 rule. I want to discuss just a few of those reasons this morning because they remain relevant to the valuations that would be subject to fiduciary status under the 2015 proposed rule.

First, appraisers firmly believe that an unavoidable conflict exists between, one, the ethical and legal obligations of appraisers to be independent of all parties to a financial transaction, and two, the ethical and legal obligations of fiduciaries to act solely in the interest of plan beneficiaries. Notwithstanding EBSA's dismissal of this concern, we believe this conflicting duties issue is real and impassable. We think the issue will be raised by plan fiduciaries or other parties to plan transactions when someone believes the appraiser who valued the property has made a decision that is not in the best interest of the plan beneficiaries.

Our concern is widespread. We're confident that it is shared by the entire community of appraisers, including members of the appraisal foundation, and very likely by other plan stakeholders. We respectfully disagree with the Department's view that the duties of professional appraisers to be independent of all parties and the duties of fiduciaries to safeguard plan assets are not in conflict. If the final rule includes appraisers within the fiduciary duty -- excuse me -- within the fiduciary definition for plan-related valuations, we think it's inevitable that this issue will have two adverse consequences.

One, it will be a major source of confusion among appraisers trying to reconcile and balance these two obligations, and two, it will give rise to disputes, some of which will surely end up in litigation between appraisers, plan trustees, and participants.

Our concerns about this conflicting duties issue are no less acute simply because under the proposed rule these conflict issues will only affect valuations of property that do not involve employer securities held by ESOPs. While individual transactions most likely represent a minority of ESOP and other plan valuation engagements, we believe they are of sufficient number and importance to put many providers' valuation services to ERISA plans in great jeopardy. In short, this is impractical and it's unfair to expect appraisers to adhere to conflicting legal obligations.

Second, including appraisers in the proposal's definition of fiduciary would substantially increase the cost of these appraisals covered by fiduciary requirements, costs that would be incurred by plan beneficiaries and their sponsor companies. This is because appraiser ENO insurance policies do not currently exclude claims -- include claims based on fiduciary liability. Adding such coverage to existing policies, if possible, would require carriers to initiate a complex and time-consuming underwriting process to determine the costs and conditions of such coverage.

Third, making appraisers fiduciaries is an unproven way to improve and ensure the reliability of plan appraisals, and it is inconsistent with the way other federal agencies regulate appraisal practice. Given the fact that no federal agency and no state agency has ever regulated appraisal practice by imposing fiduciary status on appraisers, there is no evidence that doing so will produce better valuations.

DOL's proposal, if it were incorporated into a final rule, would be a case of first impression, an experiment that we believe would produce a series of negative consequences and impassable conflict without a meaningful likelihood that appraisal reliability would be improved.

The appraiser as fiduciary concept is an experiment with a highly uncertain outcome. However, there are other tried and true ways to accomplish EBSA's worthy objective of better quality appraisals. Agencies such as the IRS have adopted workable policies that have proven both effective and manageable.

Finally, EBSA has commented that notwithstanding its decision to exclude valuations of ESOP securities from fiduciary requirements it continues to have concerns about such valuations that it may want to address in a separate regulatory initiative. The possibility of such an initiative adds weight to our position that all ERISA-related appraisals should be excluded from the current proposal.

It would be inconsistent, burdensome, and frankly unfair to require an appraiser valuing company stock held by an ESOP to be subject to different duties than an appraiser valuing company stock held by a 401(k), for example. The same could be said about an appraiser valuing real estate held by an ESOP having different duties than an appraiser valuing company stock held by an ESOP.

The logical and straightforward way to avoid such inconsistencies is to exclude all appraisals from the fiduciary provisions of the 2015 proposal and instead cover them through an alternative process such as that underway for ESOPs.

We hope EBSA agrees with our assessment and will expand the ESOP stock carve-out to other assets and other ERISA plans, and we respectfully urge the agency to take this important step before finalizing the rule.

In closing, the ASA supports EBSA's goal to improve the quality of appraisals made for ERISA plans. In the event that EBSA undertakes a separate rulemaking initiative, ASA would be pleased to work with the agency to fashion an approach that satisfies the DOL's regulatory goals and is cost-effective and fair. Given ASA's multi-discipline membership, we believe we're in a unique position to assist EBSA in connection with that initiative.

I'd be happy now to answer any questions you have about ASA's testimony.

MR. HAUSER: Thank you.

Ms. Dudley, maybe starting with you. First, maybe just to put your mind at ease, the rule does not cover casual conversations, unless by causal conversations you mean somebody like wearing a polyester while making a specific investment recommendation, but the rule requires to trigger fiduciary status that there be a recommendation, and a recommendation really is a call to action, you know, a suggestion that you purchase an investment, that you pursue an investment strategy. So, with that understanding, does that take care of your concerns about the call centers and what have you?

MS. DUDLEY: Well, partially because I trust you, Tim, and I think it's great that you're saying that, and if you would clearly write it in the regulations, I think that would even be greater because I do think there is some uncertainty in the terminology that's used in what you've proposed and I think people interpret it differently, and I think people have that concern, so why not just be really explicit.

MR. HAUSER: Right. Well, we try to be quite explicit by specifically referencing the FINRA standard and by defining recommendation as we did, and I guess, I mean, it would be helpful to know what other things you think we need to say or where you think that, you know, the issue stems.

MS. DUDLEY: We can come back and give you some examples of things that would help, and you might want to also consider doing some frequently asked questions and some examples of what's --

MR. HAUSER: Okay.

MS. DUDLEY: -- okay and what's not okay. I mean, I think that that would help a lot too.

MR. HAUSER: Right. And again just so we're clear, I mean, sometimes this observation is coupled, and I think it was in your comment letter, with a statement that it's information specifically directed and that's where the problem is, but that's not quite right because it needs to be a recommendation specifically directed, and so you pick up, you know, this concept that I was just discussing, and maybe that's one area to give some clarity. But it certainly does not pick up casual conversation.

MS. DUDLEY: And it's also -- you know, it's not just the -- and I appreciate that very much and appreciate the public statement that it doesn't, but I think it's also those conversations that are not just casual but also the concern that we have about conversations that are in and around investments but aren't specific to a specific recommendation, and I think we need to work together on that to make that clear what people can and can't do.

MR. HAUSER: So, if we talk about that for a second, the chief change that maybe contracted the scope of investment education from the previous guidance was saying that when it comes to asset allocations you can't associate, you know, the specific product reference to the asset allocation. You can't tell somebody, you know, 40 percent in a large cap and such as and then say, you know, the Hauser large cap fund. That seems like a recommendation to us.

But the suggestion has been made that one way to deal with that in the plan context is to permit that once you give that kind of asset allocation guidance to permit the person giving the guidance to illustrate the asset allocation with -- populate it with all of the funds that fit the bill under the plan menu. Does that work for you guys?

MS. DUDLEY: I heard that in the exchange over the past few days, and I think that's a really good, you know, solution to explore. I'm a little bit concerned, just if I can throw one thought your way, that in doing that you want to be careful that you're not confusing the participant by saying, you know, okay, there's this and there's this and there's this, when really what they're asking is something more specific or more targeted to their situation. So you don't want to overwhelm them. So there has to be a fine -- there's a little bit of a give and take on that, you know.

MR. HAUSER: Right.

MS. DUDLEY: So maybe all of the funds that would be applicable or, you know, but maybe not --

MR. HAUSER: Sure.

MS. DUDLEY: You know, something along those lines. I mean, I think it's a great solution to explore, but I think we need to massage it a little bit.

MS. MARES: So let me just follow up on that because having lived in that world --

MS. DUDLEY: Uh-huh.

MS. MARES: -- I understand, and I just wanted to add some clarity. So I think if the asset allocation was large cap, small cap, and the fund had four large cap options and three small cap options, today you'd populate it with one of the four choices and one of the three choices.

MS. DUDLEY: Uh-huh. Right.

MS. MARES: If you had to give all four choices and all three choices, how does then -- how should we expect then the person that's narrowing that choice to be making that decision, and what procedures are in place so that the decision is neutral or maybe it's not neutral and someone is actually expressing some analysis and advice? So talk to me about how you would then narrow that.

MS. DUDLEY: And I'll go back and get more input for you guys on this.

MS. MARES: Okay.

MR. HAUSER: So, you know, I'm more of a messenger than having lived in that world.

MS. MARES: Okay.

MS. DUDLEY: But let me just make a couple of suggestions in that regard. So your question is around the person that's narrowing the list to then share with the participant.

MS. MARES: A specific recommendation of a specific choice.

MS. DUDLEY: Well, I think you're going to have to give them a little bit of guidance in the regulations about narrowing the choice there, but I think that to the extent that the person has been directed and educated about the funds they can say, you know, there are four funds that fall into this category, you know, so that they're identified. And then they might want to specifically say I'm not telling you which fund to choose within that category.

MS. MARES: Okay.

MS. DUDLEY: A lot of our plan sponsors have policies in place that at that point they would say we offer you a service and this is how you access a service such as Financial Engines, and you want them to be able to do that as part of that conversation.

MS. MARES: Okay.

MS. DUDLEY: So does that help a little bit?

MS. MARES: That does.

MS. DUDLEY: But I'm glad to collect input on that specifically.

MR. HAUSER: So, and then getting back -- so apart from that issue and let's suppose it were resolved that way, you know, by letting people populate with all of the matching funds essentially in the plan context. You know, after that the way in which we've changed the interpretive guidance is by expanding it.

MS. DUDLEY: Uh-huh.

MR. HAUSER: We have actually added more education as treated as not fiduciary --

MS. DUDLEY: Right.

MR. HAUSER: -- rather than the converse. So I assume there's no objection there.

MS. DUDLEY: No, there's no objection there.

MR. HAUSER: Okay. And then so maybe if we could talk for a minute about --

MS. DUDLEY: But, Tim, I have to add one more thing if I can.

MR. HAUSER: Please do.

MS. DUDLEY: I'm sorry. But one thing you have to -- you need to rephrase or reframe some of what you're doing around education because messaging is pretty important in this environment and pretty important to plan sponsors, and so you want to take some extra steps to illustrate some potential uses of education and of the interpretive bulletin so that people don't have the sense -- when I go around and I really have talked to lots of plan sponsors, as you know, and they have the sense that you're telling them to pull back.

MR. HAUSER: Well, do you think they might be influenced at all by those talking points that say casual conversations are treated as fiduciary? Because I think they might be.

MS. DUDLEY: Well, I don't actually have talking points out on this because I really haven't done that, but I don't think that they're influenced. They're not a membership that lets me tell them. They're a clear membership that tells me, and I am very aware of my role as the recipient of information.

MR. HAUSER: So, on that score, you know, obviously, when you submit additional comments, I mean, we tried to be pretty specific in the education guidance. If you read it, it's the long -- I mean, in terms of rule text, it's easily the longest section of the fiduciary rule, and it goes on, you know, quite a bit about all the different things you can talk about, you know: plan or IRA contributions, the impact of pre-retirement withdrawals and retirement income, retirement income needs, varying forms of distributions and on and on with, you know, the attributes of the investments and all the rest.

So, if there are specific conversations that you think it would be helpful for us just to make clear where you think there's some ambiguity, it would be good if you provided that for us.

MS. DUDLEY: Glad to do it.

MR. HAUSER: And then if you could tell me why you think if -- assuming a recommendation in this context means that and the person making the recommendation is, you know, really telling the customer effectively -- an objective person would think they're telling me to invest in this fund, to pursue this strategy.

MS. DUDLEY: Uh-huh.

MR. HAUSER: Once that's established, why would anything need to hinge on an agreement? If they've done that and they're an investment professional, they've essentially told the person you should put your money here, pursue this strategy, and they're going to get a fee out of that, why should we layer on on top of that a requirement that there be a mutual understanding, and after answering that, a mutual understanding of what exactly?

MS. DUDLEY: I think that what plan sponsors are saying is that when a conversation happens both parties need to understand that the back-and-forth communication is about the plan assets, about what they're -- and their plan participation. It's a considered judgment, it's a judgment, and maybe that's where we get into solving the problem by dealing with clarifying the recommendation side of it.

So I think it sort of hinges on the fact that the person had a thoughtful, considered response that is telling them to do something. And so I don't know that it has to hinge on the words in my solution of a mutual understanding versus a recommendation, but there has to be some understanding that that is a recommendation.

MR. HAUSER: Well, why isn't it adequate that there is an understanding -- I mean, is it -- well, maybe that's the question. I mean, is it enough that an objective person would have understood that, look, you're recommending I make this particular investment? Do we need more to get to fiduciary status?

MS. DUDLEY: I don't know that you do. I think that if the recommendation is actually a recommendation and not just for consideration. You know, there's a difference between a recommendation and something that's just for you to think about, and so I think maybe that's where we need to be sure we're all on the same page. And I think we can give you some examples and that might help you.

MR. HAUSER: Okay. Mr. Tarbell, just very quickly, two things maybe. The first is you are aware that the current regulation, the 1975 regulation, covers appraisals except for ESOPs? Yes or no?

MR. TARBELL: No.

MR. HAUSER: So you're asking for us to change the status quo rule because the rule as currently done, there's a five-part test, but if you're giving a statement as to value, it covers both recommendations in the sense of invest in this asset and valuation work.

MR. TARBELL: My understanding is the test valuations currently do not fall under fiduciary standard because they do not meet that five-part test. Is that -- are you saying that's incorrect?

MR. HAUSER: I'm saying if you render advice as to the value of a security and you do it -- and you meet the five-part test you're in. So, if you do that on a regular basis, you have a mutual agreement arrangement or understanding with the plan fiduciary, that that advice is going to serve as a primary basis for the investment decision, and it will be individualized. That would appear to me to meet the five-part test. We carved out --

MR. TARBELL: So under your logic, we're already fiduciaries?

MR. HAUSER: Not ESOPs because we had a carve-out for ESOPs. I guess what I'm telling you is while we've changed the five-part test, you know, we had an old advisory opinion that said it was different for ESOPs, but under the rule as it exists, it literally covers advice as to the value of a security, for example, or advice as to the value of other properties.

So, if you do that regularly, say you're retained by a plan and you on a regular basis do the valuation work for them in connection with new asset purchases, you do it with respect maybe to annual valuations and the like, at least arguably you're picked up here. I mean, so part of the thinking, I guess maybe this is just explaining, we are changing the five-part test, but in a way we're just preserving the status quo as far as the distinction between ESOPs and other classes of property go.

But anyway, there's not really a question thereafter did you know that. But the other, you know, question I guess I have is, and maybe this is just one of those things we have to agree to disagree about, but I just don't think the advice relationship, you know, a duty of loyalty under the advice relationship requires one to slant that advice to tell the recipient what they want to hear, and that's always what it seems to me like your position is when you say there is an incompatibility between the duty of loyalty and the appraiser's job.

It seems to me the appraiser's job is to arrive at the best estimate of what the asset's likely trade, you know, at in a market transaction, and your job as a fiduciary is to give the investment decisionmaker your best judgment on what that number is so they can make the best possible decisions for the plan, but you don't do them any favors by giving them a slanted number, do you?

MR. TARBELL: Well, we sure would if we made it a lower value and they were buying securities. That would absolutely be in their best interest to have a lower price.

MR. HAUSER: And I suppose one -- but I don't think that's the job of the appraiser.

MR. TARBELL: Oh, no, it absolutely is not.

MR. HAUSER: And I don't -- no, no, I don't think that's --

MR. TARBELL: And that's the point. You're right.

MR. HAUSER: No, no, that's not the point, and I don't think that's what loyalty means in this context either. It's strictly, you know, giving the best advice, and in the case of an appraiser, it's giving that best estimate, and we can clarify that however you want, but would a statement in the preamble or in the text that just made that clear, here's what that duty means in this context so that you had no question that all we were asking for was that you give your impartial best judgment of what the right price is? Would that remove the incompatibility as you perceive it with your appraisal duty?

MR. TARBELL: Well, I don't think so because if that was the clarified objective, then it wouldn't follow that there's any need to make us a fiduciary.

MR. HAUSER: Well, but there's no -- I'm --

MR. TARBELL: Because all you're doing is making a statement of fact which is what an asset is worth, but we're making no recommendation as to whether it's the proper investment for the plan. I mean, we're basically akin to when one makes a purchase of a publicly traded security and they look up in the newspaper what Bloomberg or what the quoted price is that day. That's no more of a recommendation than what we do.

MR. HAUSER: Well, as you know, I've done a lot of appraisal cases, and that just isn't so. I mean, an appraisal reflects your expert judgment. If we don't have a ready market price, that reflects your judgment as, you know, based on a whole host of calculations, assumptions, and expert judgment calls about what that asset is going to trade at.

MR. TARBELL: I agree.

MR. HAUSER: So it's not just a fact. I mean, it's expert advice.

MR. TARBELL: But none of those items are a recommendation on what action to take. There's no investment decision --

MR. HAUSER: I see your --

MR. TARBELL: -- inherent in an appraisal.

MR. HAUSER: Well, it's advice in a sense on what price one should pay, yes?

MR. TARBELL: It's not a price -- no, it's not. It's not advice on what price one should pay. It's advice on what the fair market value is. Whether the plan should pay it or not pay it is the trustee's decision. We don't care. That's what independent means. We don't care whether you act on this price or not, and we don't care whether you're a buyer or a seller. It's simply the fair market value. Do what you want with it.

MR. HAUSER: Right. But it's I guess the

nature of virtually all advice, isn't it, that the recipient of the advice in a sense is ultimately the decisionmaker? I mean, that's no different than any other context.

MR. TARBELL: Well, no because the other constituents that are testifying about the impact on their business are providing advice, I believe, which is this is what we recommend for you, and there's no aspect of that in an appraisal.

MR. HAUSER: Right. And then just one other point and then I'll stop talking. But what we do have in mind in the rule, though, and maybe here is an area where it needed -- there's additional clarity needed was that the advice would only -- you know, we really did have in mind the plans hire somebody in connection with a specific transaction and they're looking for an appraisal in connection with that transaction. It's true we have a separate carve-out that deals with, you know, valuations required by law, but unless the plan -- but that's what we're picking up. We're not trying to pick up kind of these annual appraisals, these reporting obligation sort of things, these fund values, you know, divorced from that kind of --

MR. TARBELL: So transactional only.

MR. HAUSER: Yeah, that's --

MR. TARBELL: That would greatly clarify.

MR. HAUSER: Yeah.

MR. TARBELL: We would like it to go further and not include the transactions, but that would be a great step.

MR. HAUSER: Right. And we're definitely thinking hard about that comment as well. Thank you.

MR. CANARY: Okay. Lynn, a couple of questions. In your comments, there seemed to be a recognition of a difference between the HR employees and call center employees. So let's talk about HR employees just to begin with.

MS. DUDLEY: Sure.

MR. CANARY: One of the things as we went through this we thought was important was to be a fiduciary you have to be receiving a fee for the advice, and I think what we've heard is in the case of HR employees that's not really happening unless you classify their normal salary as a fee that would bring them within the rule. So rather than trying to clarify other provisions, would approaching the HR issue from that direction be helpful just to clarify what would constitute a fee?

MS. DUDLEY: Yes, very clear recognition of that in some way is really valuable, Joe. There is --

I've heard that discussion over the past few days and I've heard that discussion even before that, and there is just -- anytime there's a major change like this there's just huge uncertainty, and it's not worth that confusion or having that tested in some court somewhere. Just clarify it.

MR. CANARY: Okay. So call center employees seem a little different, though.

MS. DUDLEY: Yeah.

MR. CANARY: Because the call center employees actually can be an affiliate of the investment provider --

MS. DUDLEY: Yes.

MR. CANARY: -- or an affiliate of the advice provider to the extent you're talking about referring somebody to the advice provider.

MS. DUDLEY: Right.

MR. CANARY: In those circumstances, there seems to be a different kind of tension where that call center -- even a compensation structure where they're getting bonuses or other compensation based on the number of referrals or other measures, you could end up with a conflict being built into that relationship. No?

MS. DUDLEY: You could, but go ahead. You were going to ask.

MR. CANARY: And I suppose -- I was listening to some of the comments and again there is there a sense you focus on what constitutes a fee, where the call center employee is not being paid in a conflicted space?

MS. DUDLEY: I think that's possible. A lot of call center employees are not specific to a particular plan. There's some flexibility as to who's answering the phone. I think there is some clarity that you can add around additional compensation, you know, over what they get paid as salary, but I also think you all need to maybe take a look at the kinds of questions, and we can share some of those with you, but I think there is some need to kind of make sure that it's clear that the line -- that people are not crossing the line when they're helping people frame the question or when they're talking about an age-appropriate target date fund, or, you know, in some cases, somebody may notice, a call center employee may notice that a person has split their, you know investments into multiple target date funds that have nothing to do with what they ought to be in, and, you know, calling their attention to taking a look at that, that's not really investment advice. It's helpful information that they need to go back and follow up on. It engages them, but it's not advice.

MR. CANARY: Okay. Thank you.

Mr. Jones, I think the last panel, there was an observation that if there was a need to move someone from a brokerage account into an advisory account that that would inevitably result in doubling the fees, and the example was given of a laddered bond investment portfolio. Can you give your reactions to that?

MR. JONES: Sure. I think there have been a number of assertions that somehow a fee-based account is inherently more expensive than a brokerage account, and there is certainly -- you can come up with examples where that might be true, but there are a wide range of ways that nonconflicted advice or unconflicted advice is charged for. It's charged for by the hour in some cases for fixed fees, in some cases it's for asset-based fees. It's certainly not always 100 basis points or 150 basis points. There are a number of vendors, ourselves included, that have fees that are quite a bit lower than that.

With respect to something like a bond ladder, obviously if the individual is able to construct the ladder and maintain it on their own, there's no need for an advisory fee at all in that circumstance. They could simply open a brokerage account and do it themselves. To the extent that they need more hand-holding to understand how to set that process up, that might be a fixed-fee type of contract up front. It might be an advisory fee on some sort of periodic basis.

So we would categorically reject the notion that the commission-based sort of conflicted advice model is somehow always cheaper than the unconflicted model. We certainly don't think that's true.

MR. CANARY: Thank you.

Mr. Tarbell, one question for you is so we adjusted the definition provision on valuation from the 2010 proposal to the current to make it clear that the valuation information has to be in connection with a specific transaction, and we also broadened out some of the sort of carve-out provisions where valuation information to an investment funds in which plans invest would not be covered by the rule.

With the ESOP exclusion, can you help me? What are the main classes of investments that are still of concern to you where the rule would make the valuator potentially a fiduciary?

MR. TARBELL: I think one example might be sponsor or company stock held by a 401(k) plan or another -- I don't think it's realistic that it's in an IRA, but that theoretically could happen.

MR. CANARY: Okay. So stop on the 401(k) for a second.

MR. TARBELL: Yes.

MR. CANARY: So where is the specific transaction where that valuation of the 401(k) employer securities would meet the definitional provision?

MR. TARBELL: The day that the 401(k) bought the stock or the day that the 401(k) sells the stock.

MR. CANARY: But it's the valuation for that purpose, or is it just a valuation that's provided for the plan which that information is then used or potentially could be used in connection with particular transactions?

MR. TARBELL: Well, I mean, if your question is -- let's back up. The 401(k) had to buy the stock at some point, and when it bought the stock, let's assume that the fiduciary of the 401(k) sought a fairness opinion or at a minimum sought a valuation. My reading of the rule is that that valuation or fairness opinion would qualify for fiduciary status.

MR. CANARY: Okay.

MR. TARBELL: And here's the example of the inherent silliness of that, is that if -- let's say that you have a 401(k) that buys 1,000 shares of that company's stock, and that transaction would qualify the appraiser for fiduciary status. But if in the same company an ESOP bought the same 1,000 shares, it wouldn't qualify for fiduciary status, but it's the exact same question. In each case, the question is what is the fair market value of the stock that the qualified -- ERISA plan is buying. Why should those two transactions which are asking the appraiser the exact same question be subject to different standards?

I mean, it's almost as if you expect the values to be different in those two situations, and there's absolutely no reason they should be. So, if not different values, why different standards?

MR. CANARY: So can you give me -- what's an example other than an employer's security where you'd be concerned about the scope of the rule reaching valuations that are provided in connection with specific transactions?

MR. TARBELL: I am a business appraiser, so I can't say that it would affect me in any other aspect than securities, but I think from an ASA perspective, you know, we cover real estate, personal property, machinery and equipment. The real estate would seem to me to be the most likely example of an asset that could be acquired by an ERISA plan.

MR. CANARY: Thank you.

MR. HAUSER: You're overarching our classes; just that if we're going to look at appraisals we do it entirely separately from this project.

MR. TARBELL: Did you say ovearching or -- I heard overreaching, but I think -- you said overarching.

(Laughter.)

MR. HAUSER: I would not and I did not bring that to the question.

(Laughter.)

MR. TARBELL: Well, the idea is this. Ninety-nine percent of appraisals for ERISA plans are going to be employer stock held in ESOPs. And your plan to address those separately, and I'm making this up now, but in some form of maybe replacing the '88 proposed reg with a new reg on --

MR. HAUSER: Adequate consideration reg, yeah.

MR. TARBELL: Awesome plan. That plan is, if good for 99 percent, why not good for 100?

MR. HAUSER: So you want it to be just

completely awesome.

(Laughter.)

MR. TARBELL: Absolutely right, but it seems to me that whatever form that alternative idea

takes --

MR. HAUSER: Yes.

MR. TARBELL: -- place in, maybe the preamble to that should just say this is fair -- this concerns adequate consideration (fair market value) for any asset acquired by any ERISA plan, and then if we have solid rules, the DOL to me it seems like then has a cause to go after appraisers if they violate that reg, but we're still not fiduciaries and we're all happy because you have a cause and rules that we can be held to, and we're happy because we have defined rules finally of what to be held to, but we don't take that gigantic step of being fiduciaries, which we don't feel we are.

MR. HAUSER: Okay. I understand your view. Thank you very much.

MR. TARBELL: Thank you.

(Panel switch.)

MR. HAUSER: Good morning. So, if we're doing this in alphabetical order, Mr. Goldberg?

MR. GOLDBERG: Oh, I'm first?

MR. HAUSER: Am I right? Makes no difference to me. Makes no difference.

MR. GRADY: We could say ADISA before IPA. How about we try that?

MR. HAUSER: There you go.

MR. GOLDBERG: Yeah. There you go, alphabetically.

MR. GRADY: Good morning, and thank you for taking the time to really put so much energy and effort into these hearings. We appreciate it, B&C appreciates it, and your stamina is remarkable. I can note.

My name is John Grady. I'm the Chief Risk and Strategy Officer for RCS Capital, but I'm here today on behalf of ADISA, which is the acronym for the Alternative and Direct Investment Securities Association, an association with roughly 4,000 members who focus primarily on the creation, management, distribution and servicing of alternative investments, many of which are what we'll call non-listed or non-traded. My colleague, Mark Goldberg, on behalf of the IPI -- IPA, excuse me, and I are going to talk about them in more detail, but they are in many cases direct sold and non-traded to distinguish them from other types of investments.

So before I get to what we really want to focus on as ADISA I wanted to just echo a few points that we put into our comment letter that we think are important to reiterate in this context.

I think I would start with the idea that the hearings and the proposal itself are based on the concept of conflicted advice. It's all over the proposal, it's in the rationale, and you've had full panels testifying to the concept of conflicted advice and how the rule proposal exemption would function in that context.

I think I would just like to take a step back and say that I think it's a difficult and perhaps unfortunate lens through which to look at, at least the community of financial professionals that are being held out as acting with conflict, consider them the independent broker-dealer community for ease of reference. I think that to view everything through the conflict lens, which really comes down to a cost and compensation lens, that's how we're defining conflict, tends to do several things, and I'll just touch on a couple of them and then go back to the alternative products point that I want to focus on.

I think first and foremost by emphasizing cost and emphasizing compensation as conflict items it tends to minimize the total relationship involved in a financial services professional's client relationship with his or her and the firm's clients. Those relationships go typically far beyond an IRA or other retirement savings account. They involve everything from advice on taxable monies, savings, insurance, planning, including estate planning and current lifetime planning, and a host of, and as the gentleman from Stifel said, a host of accounts that go well beyond the retirement savings account context.

So, in doing so or in focusing on the idea that there's conflicted advice here and focusing on, of course, the accounts that the Department of Labor has special statutory purview of, I think it tends to cause the entire regulatory regime in which the financial professionals we're talking about operate in. In other words, what you're proposing is the creation of regime that would sit side by side but mostly ignore the regulation through FINRA and through the SEC of the industry and of the professionals that work in the industry.

So I think that by defining this as emanating from conflict and using that as the lens, and I understand the tools are somewhat limited, we're talking about whether someone is a fiduciary or not, and going back to 2010 and 2011 hearings that was obviously an enormous focus of your proposal then and now, which is to ensure that the right people are picked up by that definition, but that definition is very far-reaching and tends to focus on cost and conflict at the expense of some of the other factors that go into these relationships, which to boil them down you might put under the category of return of result.

I don't think that looking solely at cost and compensation is necessarily the only way to look at the availability of that financial model and the desirability and really ultimately the survivability of that model. And because we've put that business model in place and on the table in these discussions, I just want to make two additional points.

Many of us have said that we don't see the broker-dealer community adopting the BIC exemption, instead moving away from it. But there are always those who will move toward new regulations and those who I think could be counted on or at least theoretically counted on to adopt whatever that exemption requires.

If so, what I would point out is that then you will have, if that exemption holds the way it's been proposed, a very different set of rules applicable to one set of assets or accounts inside a much broader and complicated financial relationship.

I don't think that's advisable, particularly if the types of investments that can be sold pursuant to the exemption are limited as the definition of asset provides and as Mark and I want to talk about in a moment.

So even if we go forward with the exemption I think there's a problem with respect to differential treatment of retirement saving accounts from the other types of accounts that are typically in the purview of a financial advisory relationship, and then there are those who say they won't do it, that they will effectively abandon the space because they can't serve it or won't serve it, whether it's because of paperwork, cost, viability or otherwise. I think the witnesses who have talked about those factors are truthfully telling you that they would radically rethink whether to serve those clients if those are the rules for doing so.

So I think what we have to be careful of is the unintended consequence here of what in the U.K. is being called the advice gap that resulted from effectively disincenting a portion of the financial services industry from serving clients, which can be the abandonment of newer investors with small balances, older investors with small balances, and in general, investors who have lower retirement savings levels.

When you named it the best interest contract exemption, I admired your use of the English language, but I hope you would understand that from our perspective the best interests of the investor is advice. I say that because I think, although there are many studies and many different ways of slicing the data you've received, I think folks have shown and I think the industry believes it can be demonstrated objectively that advice helps the outcome, advice helps the result.

So I think if we can do anything to achieve the best interest of the investor and retirement saver community it would be to augment or to build out to the greatest extent possible the access to advice, and to call it conflicted and leave the analysis there I think underserves the issue and potentially has unforeseen consequences that I just don't know are in the best interests of either the retirement saver community or the American saving public generally.

With that, and Mark's going to talk in more detail about our products, on the assumption that there is an exemption and that broker-dealer firms would have to comply with the best interest contract exemption to transact or recommend to their clients products that have variable compensation arrangements, there's a definition of asset that at the proposal level excludes many of the types of products that ADISA members distribute, manage, sponsor, and service.

These are, as I said, non-traded. They are typically investments more in assets than in securities, so they might be investments in real estate, in the case of non-traded REITs or non-listed REITs, business development companies which are effectively lending vehicles that have grown in place of the banks' withdrawal from the middle market lending, as well as oil and gas programs, 1031s, DSTs, private funds, there's a host of products and descriptions, I would say all of which would be excluded by the definition as proposed.

I think that we can all read in and infer from the language in the release that the basis for that exclusion would be lack of liquidity, lack of transparency, and/or lack of marketability, and it is true that those are factors in the construction of these products. It's also the case that these are factors in their attractiveness inside the regime of an overall advisory account or advice program.

So what we want to basically reiterate is that there's been a great deal of financial inventiveness and we are one of the world leaders in creating products that work to serve the needs of investors. If we use a list-based approach to identifying what is and what is not appropriate for retirement investors, I think we run the risk of not keeping up with innovation and of actually cutting off retirement savers from products that could work to their ultimate advantage as savers and as investors. I'll stop there.

MR. GOLDBERG: I'm pleased to represent the investment program association and it's good to see you again. John and I didn't quite coordinate as much as you might think, although it was interesting to hear his comments. We would firstly like to thank the Department for reviewing our submission, it was long, had a long appendix to it, and for our meeting on

June 4 that went quite long. We appreciate your willingness to listen and to get to a final rule that is workable.

Our focus of our commentary relates very narrowly to the best interest contract exemption. Our concern is twofold: first, the Department -- the way it's currently written seems to deviate from principal-based approach with the use of a list; and second, the definition of assets is narrowly defined and precludes access to investments that we think otherwise fit under the Department's definition of common investments.

Until the early 1940s many states required trustees to select investments from a statutory list and purportedly safe investments. Periodic economic crises and market corrections have demonstrated that virtually no investment is immune from risk and that even the safest investments can experience steep and permanent declines in value. The use of legal lists reflect a since discredited assumption that past performance reliably predicts risk, and strict use of lists will fail to adapt to changing economic and business conditions.

The drafters of the Restatement of Trust concluded that knowledge, practices and experience in the modern investment world have demonstrated that arbitrary restrictions on trust investments are unwarranted and often counterproductive. Modern fiduciary investment principles were driven by dissatisfaction with poor investment performance in legal list jurisdictions and by a large body of academic research. ERISA was the first legislation commendably to apply modern portfolio series to a fiduciary investment standards, and I'd like to read an excerpt outlining a particular dissatisfaction.

"We do not consider it appropriate to include in regulation any list of investments, classes of investments, or investment techniques that might be permissive under the prudence rule. No such list could possibly be complete and investment reasonably designed as part of a portfolio to the further purposes of a plan that is made upon appropriate consideration surrounding facts and circumstances should not be imprudent."

This excerpt is not my words but the Department's words on prudence taken from the preamble to the 1979 regulations, Section 404 of ERISA.

Beyond the DOL's own guidance as to the unsuitability of legal lists, the notion of common securities is somewhat problematic. The rulemaking process is lengthy and complex. In this case, it comes about once every 40 years. What is common practice today was unimaginable years ago, and what will be commonplace in five to 10 years is equally unimaginable.

By way of illustration, if we were to turn the clock back to 1993, the very first exchange traded fund was established. It would not become common for another decade. Had this law been written at that time, it might have excluded ETFs and also might have inhibited the adoption of this important investment vehicle.

The Department suggested that future exemptions can be requested either by a separate PTE or as an addition to the list. Such a procedure is long, expensive, and uncertain. It would also suppress innovation. Assuming common in the market is a requirement for a PTE, how could a new idea arise and become common if it hasn't yet been allowed in retirement accounts, which as you know holds trillions of dollars of investments?

A legal list would invariably fall behind in ever-changing market conditions and fail to keep pace with advances in products and portfolio construction theory. As we understand it, it was not the Department's intention to pick winners and losers, but that is exactly what a legal list does. We encourage the Department to reconsider using the methodology previously discredited by the Department itself and the single most respected secondary source, the Restatement of Trust published by the American Law Institute, which brings me to my second point.

If the Department generates a list with common securities as its core principle, then the list must be fully inclusive as possible. Millions of Americans already hold public products in their IRA accounts. These investments typically offer individual investors access to a variety of asset classes with different correlations, including publicly-registered non-listed REITs, business development companies, as well as other direct participation programs.

These investments are distinguished by providing income distributions and less on projected growth. They offer the potential to hedge inflation through the ownership of real or indexed -- inflation indexed assets while providing a limited level of liquidity and avoiding exposure to the volatility of traded markets.

The IPA believes these products possess attributes that complement retirement investment objectives. In moderation, these portfolio additions can provide asset class diversification, incremental portfolio diversity beyond traded securities, and within the broad context of the definition of prudence these products would have to be included as options for an appropriate investor. The duties of prudence and loyalty are sufficiently robust to protect retail investors regardless of the product type.

The Department may ask if an allocation to real estate is needed why not simply construct a portfolio using exchange traded REITs? We believe it prudent to employ both exchange traded REITs as well as non-exchange listed funds. Major institution pension plans have historically done so through direct ownership of real estate and non-exchange traded funds, a strategy that helps insulate portfolios from price volatility in the securities markets because while the value of an underlying real estate asset may not change dramatically prices can.

For example, the RMZ price index, which is a basket of traded REITs, has experienced large one-day declines ranging as high as 19.7 percent, value swings exceeding 5 percent have occurred once on average every 20 days in the past 10 years. The value of owned real estate held by these entities hasn't changed nearly 20 percent in a day or even 5 percent a day. What changed is the price of that security that it represents as a proxy.

The difference between price and value is representative of the volatility of liquid markets. Changes in perceived values at the Federal Reserve, rumors about China, Greece, or the price of oil can impact market prices as money flows into and out of the market even if the underlying fundamental values have not changed. Fluctuations in price tend to induce retail investors to sell in declining markets, purchase in rising ones. This is exemplified by the Morningstar Investor Return Matrix.

Such volatility in our opinion is a tradeoff for the benefit of optimal liquidity. While generally positioned as long-term investments, the public products we represent are often structured to provide opportunities to obtain liquidity through redemptions, tender offer of shares, which is determined by an independent third party based on the value of assets. This in turn ensures price received is equal or close to value of assets irrespective of a good or bad day in the traded market.

Although limited liquidity of these products is not equal to market liquidity, realizing value that is not tied to systemic market movements is indeed an advantage, particularly as one contemplates portfolio construction to the client's best interest. We want to ensure the Department has a full understanding of our products as currently structured and registered and regulated as they have changed from earlier generations of these non-listed products.

Non-listed products have evolved to in accordance with recent rulemaking provide even higher standards of transparency. They require annual independent valuations for BDCs that takes place quarterly. They have shorter life cycles. They have enhanced governance and independent director approval of all sensitive corporate actions.

Unlike traded public -- unlike traded securities public products do not benefit from the federal pre-exemption. They therefore not only require SEC registration and review and distribution oversight by FINRA but individual state-by-state reviews. Forty states require merit reviews. State regulators hold the authority to deny security sale in their state if they are unfair, unjust and inequitable.

One minute. State requirements include the qualification of income, minimum net worth concentration limits in the portfolio, and investors must acknowledge receipt of a prospectus five days prior to a purchase, the initial amount of time to review disclosures. Each of these items is further vetted by compliance personnel at respective broker-dealer firms. This subscription process is evidence of the level of protection afforded investors in these products and go well beyond what is inherent in an instantaneous purchase that can be made of traded securities which are exempted from these protections by statute.

In short, one, these are common investments for retail investors; two, they have superior disclosures and protections within the existing regulatory regime; three, they offer critical benefits for building portfolios that reflect the tenets of modern theory. In summary, we believe the BIC exemption should be principal-based. Standards of prudence and duty and loyalty are currently provided in the exemption and not limited to a list of securities, and if not, the legal list of securities needs to be more complete so that investors can benefit from diversification and choice. Thank you.

MR. KASWELL: Okay. Good morning. Managed Funds Association appreciates the opportunity to testify at the Department's conflict of interest hearing. My name is Stuart Kaswell, and I'm general counsel of MFA. My colleague, Ben Allensworth, is with me today as well.

MFA represents the global alternative investment industry and its investors. MFA strongly supports the Department's goal of protecting benefit plans and their participants. We recognize that imposing fiduciary status on certain service providers to plans can further that goal. We appreciate the Department's determination that valuations provided to collective investment vehicles do not create an ERISA fiduciary relationship. We also appreciate the Department's efforts to exclude sales activity to sophisticated plan investors from being deemed providing investment advice.

We believe a tailoring of the proposal is needed to achieve these two objectives. Absent changes, we believe that the proposal could impair the ability of sophisticated retirement plan investors to invest in hedge funds and other private funds.

Before discussing the specific concerns about the proposal I'd like to discuss the value that hedge funds provide to sophisticated retirement plan investors. The addition of hedge funds to a retirement plan's portfolio may provide diversification, risk management, and returns that are not correlated to traditional markets. These benefits help retirement plans meet their obligations to plan participants and help sophisticated IRA holders achieve their financial goals.

It's also important to note that securities laws subject hedge fund managers to comprehensive regulation and that investment advisors are fiduciaries to their clients, though not necessarily ERISA fiduciaries. Of course, we understand that ERISA regulation of fiduciaries is not identical to regulation under the Investment Advisors Act.

We note that hedge funds generally may not be sold to the general public or retail investors and are usually offered only to accredited investors or qualified purchasers. These are investors who are deemed to have sufficient sophistication and ability to absorb the risks associated with making such investments.

In light of the existing regulatory frameworks applicable to private fund managers, we believe that the policy concerns about gaps in the protection of plan investors, particularly retail investors, are not applicable to private funds.

When considering the application of ERISA to hedge funds, we believe it is important to focus on the manager's investment decisionmaking on behalf of the fund. Accordingly, the investment advisor to a plan asset fund is a fiduciary under ERISA with respect to the investment management decisions that the advisor makes on behalf of the fund, including funds of one owned by a benefit plan. We believe that expanding fiduciary status to cover ancillary activities does not provide additional protections to plan investors. In fact, such a change could inadvertently harm those investors.

I'd now like to address two areas of concern with the proposal: first, statements of value, and second, marketing issues.

First, MFA supports the Department's proposal to exclude from the scope of the rule statements of value and appraisals that are provided to collective investment vehicles. We are concerned, however, that it is not clear whether the pooled fund carve-out would extend to all statements that are provided to all fund investors or that are provided to a specific fund investor.

Many funds have service providers, such as administrators and data aggregators, that prepare and disseminate the fund's net asset value in transparency reports to investors with information about the fund's investments and providing verification of asset pricing. Uncertainty regarding the proposal is likely to create a disincentive for fund managers and service providers to disclose routine and relevant information to fund investors. Uncertainty also may make funds unwilling to accept plan investors in the first place. Both outcomes are detrimental to retirement plan investors.

We do not believe that managers and service providers are likely to conclude that the current exclusions for communications that are not made in connection with a specific transaction or that are required by law apply to the range of communications typically provided to fund investors. As such, a manager or a service provider to a non-plan asset fund risks being considered a fiduciary in connection with routine statements made to a plan investor even though the manager is not an ERISA fiduciary with respect to its investment management decisions.

We respectfully submit that imposing fiduciary status on managers and service providers to non-plan asset funds is inconsistent with ERISA. Moreover, we don't believe that restricting the flow of information helps investors.

We note that the pooled fund carve-out does not take into account a fund of one, a structure that many larger plans use. Excluding funds of one could result in less information being available to investors in funds of one, interfering with the structures adopted by plan fiduciaries to prudently make and monitor plan investments.

To address these issues, we recommend that the Department revise the proposal to permit fund managers and service providers to communicate directly with plan investors by providing information relevant to their investment in the fund and responding to investor questions without creating fiduciary obligations.

We urge the Department either to clarify that such communications are not considered in connection with a specific transaction regardless of what use the plan investor may make of them or to amend the pooled fund carve-out expressly to include communications to plan investors in investment funds, including funds of one.

It's important to remember that even under this proposed approach the securities laws would still protect plan investors from inaccurate or misleading information. We again note that fund managers to investment funds that are deemed to hold plan assets under ERISA are ERISA fiduciaries with respect to the investment advice they provide to the investment fund, including funds of one.

The second principal area of concern is the marketing and selling of hedge funds to retirement plans, which we believe should not be deemed fiduciary in nature. MFA believes that asset managers should be able to market their products and services to plan investors without being deemed an ERISA fiduciary with respect to that marketing activity. When a manager or placement agent is marketing a private fund, they are not making a recommendation to potential investors, nor are they in a position to make a fiduciary determination regarding whether the potential investor should invest in the fund being marketed.

The Department has long recognized the distinction between communications that are intended to sell a product or service and communications that constitute investment advice. The Department's existing guidance demonstrates that a fiduciary does not engage in a prohibited transaction when it acts on its own behalf to propose that a plan buy an additional service or product from the fiduciary for additional compensation.

We are concerned that the proposal could cause the sales activities of all persons who sell or market interest in funds to be a fiduciary. Absent revision, the proposal will make it difficult or impossible to market private funds to plan investors. MFA respectfully requests that the Department amend the proposal to make clear that a fund manager is not acting as an ERISA fiduciary when it markets its private funds to a retirement plan.

Alternatively, the Department could revise the seller's carve-out to permit fund managers to market investment products to retirement plan investors without acting as fiduciaries in connection with their marketing activities. MFA urges the Department to make the following amendments to the seller's carve-out:

First, remove the condition requiring a minimum number of plan participants which we do not believe is a good proxy for sophistication.

Two, clarify that the restriction on receiving a fee in connection with a transaction does not apply to the receipt by a manager or its affiliates of an asset management or performance fee or allocation from a fund.

Three, confirm the condition that the independent plan fiduciary have $100 million in employee benefit plan assets under management to existing law, namely, the QPAM exemption, which requires $85 million in assets under management.

And four, apply the seller's carve-out to marketing and sales to all retirement plan investors eligible to invest in private funds so as not to exclude to plan asset funds IRAs and other eligible retirement plans.

Finally, I want to talk about the BIC contract exemption. Further revisions to the proposal also are needed to permit an advisor to use placement agents or other third-party salespersons that are compensated in connection with the sale of an interest in a private fund. Although the proposed BIC exemption permits salespersons to receive commissions in connection with sales of certain investment products, the exemption only applies to a limited universe of investment products defined as assets, which we believe is too restrictive. It does not include private funds.

Because private funds are not sold to retail investors, revising the definition of asset in the BIC exemption to include privately offered funds would not permit retail investors to purchase such investments. It would allow plans and IRAs that are already eligible to invest in private funds to continue to meet their financial goals by purchasing interest in such funds and benefit from the conditions of the BIC exemption.

MFA appreciates the opportunity to testify and we appreciate your considering our views carefully and would be happy to try to answer your questions. Thank you.

MR. HAUSER: Thank you.

MS. MARES: So, Mr. Goldberg, maybe I'll start with a few questions for you.

MR. GOLDBERG: Sure.

MS. MARES: I certainly appreciate the diversity of investments that real estate and business development corporations, oil and gas can in fact bring, and I think our intent when we provided a list of assets was to -- and by our calculation, it covers 96 percent of the assets that are held in IRAs, so I recognize that this is a minority of the ownership but very important to you.

MR. GOLDBERG: Okay.

MS. MARES: So I wonder if you could just walk us through a typical non-traded REIT in terms of what its structure is, how investors get visibility into the assets, how the assets are valued and managed, and the different oversight of the fees in that process just so we can understand what's inside it.

MR. GOLDBERG: Well, that probably would take about a half-hour, so I'll give it topically. Part of that was in our submission and we're certainly willing to follow up with greater detail.

As I noted in the comments, first of all, there's the traditional SEC review. These are publicly registered vehicles, so they conform to all the public registrations that are required in reviews and disclosures on an ongoing basis.

Before they're deemed defective and after they're deemed defective they file the 10-Q, the 8-K, and all the formalities associated with all public products themselves. So the transparency into those products are the same as they might be in any SEC registered product or very similar so.

When you get beyond that, obviously the governance of the distribution and the sale is by FINRA, and then further to that is the states. So the states undergo, all 50 states, Blue Sky, but there are 50 merit states, there are many states that are very active in the review of that. So all the disclosures that investors see, and as I pointed out, somewhat ironically, see, prior with the five-day prospectus rule, is very robust, so all fees are described within the context of those disclosures. They're further guided by the states regarded by the NASA guidelines, which has nothing to do with the space agency. That's the securities administrators, and there are provisions in there in terms of the capping of fees. There are provisions in there with regard to the determination of qualifications for the investment.

It goes much further than the traditional traded security sale, so I would say it's rather robust, has improved greatly, particularly over the last five to 10 years, and it's my general impression, speaking somewhat myopically, you know, you're involved in your own business for a while, that the impression externally of these products is much different than the reality of them today.

MS. MARES: So given the robustness of all the disclosures, and I brought along a sample of a private placement memorandum. It's 400 pages, this particular one. So there's lots of information in there. Talk a bit then about the kind of investor that can digest all that information and really understand the investment for incorporating it in the portfolio.

MR. GOLDBERG: Okay. So is that a public or private placement?

MS. MARES: Private.

MR. GOLDBERG: Private. So my remarks were directed towards public just as an aside. But the question as to, you know, how they go through it is none of these products, at least any of the ones that I'm aware of, are available directly to the public.

You need to go through a financial intermediary in order to purchase them.

So the heft associated with these disclosures is such that it almost requires that somebody sit down and explain to a client what's involved, what are the inherent risks, obviously the risks are on the front pages of that document, I'm sure, and the document in terms of providing it to an investor is to me somewhat of a cheat sheet for the investor to ask a lot of good questions that they should, and the regulation that requires its delivery five days before a sale is allowed to be made is just yet a further protection that exists in these products that just does not exist elsewhere.

MS. MARES: So let's talk about the conversation between -- so the investor may have this, but you've said really needs to work with an advisor in assessing its suitability for their portfolio.

What conditions should the advisor consider in looking at this as part of the portfolio?

MR. GOLDBERG: Well, generally speaking, both by statute, in some states by prudence alone, and by regulations through their dealers there are concentration limits that needs -- the liquidity of the individual needs to be taken into account. The concentration within the portfolio needs to take into account, and traditionally these are limited generally speaking to well under 10 percent of a portfolio concentration.

So I think the first point of view is the need for diversification and the appropriate nature of something that is far less liquid to be a smaller portion of anybody's portfolio, particularly if you're dealing with the general public.

MS. MARES: So would there be minimum investments that someone would need to meet?

MR. GOLDBERG: Yes, there are minimum state requirements as to income, as to net worth, and as to liquid net worth.

MS. MARES: So could you talk about just an example of what that might be?

MR. GOLDBERG: It's $70,000 would be -- each state has their own.

MS. MARES: Okay.

MR. GOLDBERG: But $70,000 of income, $70,000 liquid net worth or total net worth $250,000. I would add to that that the state securities administrations are currently meeting on that topic to review and reset those standards.

MS. MARES: So we've heard a lot of data on what typical IRA accounts are, and the $250,000 is well in excess of the typical IRA account.

MR. GOLDBERG: Yeah.

MS. MARES: So these investments, as I'm hearing you discuss it, are for a select portion of IRA investors, would that be correct?

MR. GOLDBERG: Oh, gosh, yes, that would be correct.

MS. MARES: And so, if we were to consider including them -- I know you don't like the legal list environment, but if we were to consider including them, what kind of parameters would you think would be reasonable for their inclusion?

MR. GOLDBERG: Well, certainly the general parameters of prudence and loyalty. I paid close attention both through the webcast, which we appreciate you making available, and some of the commentary that I've heard directly about the issue of conflict and compensation. As I shared at the meeting on June 4, we don't have an issue with that in terms of the conflict and how people are paid.

Whether or not people should be paid within the context of a commission or a fiduciary or as a fee, they should pay the right amount and it shouldn't be determined whether or not it took the form of a commission or a fee, fee for service or fee on assets. So we have no issue with coming up with a contextual way within the BIC exemption to equalize that.

So, to remove that concept of conflict around the consideration for the financial intermediary, I think some thought needs to be given to how that is accomplished and defined because once you remove the conflicts associated with that compensation a lot of the issues that surround providing an exception or exemption I think will go away or I hope will go away I should say.

So, if I were to think about productively trying to make a suggestion associated with, you know, buttressing that exemption, it would be to address the core conflict, which is the compensation, and not to suggest one's better than the other, but to equalize them in some manner, shape or form because these are, as I said before, long duration, limited liquidity, they don't belong in substantial portion in anybody's account, whether it's a brokerage account or an IRA, but within a certain context they do belong and they do provide diversity and they do provide the correlation that people are looking for, and we'd certainly, you know, be anxious just to work on some of those things.

MS. MARES: Thank you. I have just a couple more questions. You talked about liquidity that came through redemptions. Could you talk a minute about how the valuation is done? And I understand that there can be discounts, at redemption there are discounts to that valuation price. Can you talk about how the valuation gets established and why there would be discounts?

MR. GOLDBERG: Yeah, sure. So there are certain parts of it that are uniform.

MS. MARES: Okay.

MR. GOLDBERG: There are certain parts that are becoming more uniform by regulation, recent regulation, and let me try to summarize that really quickly.

So what is required under the rule that was adopted under 23-10, which is a FINRA rule, is that an independent valuation needs to be conducted and it needs to be conducted with the valuation from assistance with a third party, and it needs to be confirmed by the independent board of directors. So it's an issue in a fiduciary type capacity of that valuation.

So, when one goes to redeem shares or they're tendered for, they're under two formats within the SEC, you can either redeem shares through the sponsor or they can tender for those shares. They're generally done quarterly. Depending on which product we're talking about it ranges somewhere between 5 and 20 percent of the outstanding shares on an annual basis. And the tendering of the shares take place quarterly. They notify that you want to tender their shares or are opting to have your shares redeemed, and they're redeemed in net asset value for some funds. Some funds have some discounts associated with them. I think the average discount would probably range somewhere 3 to 4 percent or maybe a little bit higher in the early stages of the fund.

If you were holding to liquidity or the stated liquidity of the fund, there would be no discount to NAV typically.

MS. MARES: I think I'll stop for now and let others ask questions.

MR. CANARY: Maybe just a little. I'm trying to get a handle on scope. We have the seller's carve-out which would deal with your large money managers and assuming there are some changes made on the dollar threshold for that and large plans on one level. And we also have the rule which says you have to be giving a communication it's a recommendation. So struggling with two points a little bit.

One, so what's the market that you're focused on that isn't covered by the seller's exception that is going to be you think an appropriate investor for your products? That's question one, so you can start with that.

MR. GRADY: Okay. I don't believe that we're necessarily focused on the seller's exemption in our comments. I mean, I think it was part and parcel of Mr. Kaswell's remarks, but from --

MR. CANARY: Mr. Kaswell, you can start then.

MR. KASWELL: Okay. Sorry, I wasn't sure I was on the right -- one of the concerns about the seller's exemption we have is if you provide -- there are two things we're really focused on. First is if you provide information that is like providing NAV, we're concerned that that triggers the fiduciary standard. We think that's problematic because an investor is looking for what's the NAV of the fund. And if you answer that, which may involve some judgment calls, that can then trigger --

MR. CANARY: Okay. So we're talking about there's the valuation provision where as it's drafted they're talking about providing that information to the fund manager rather than the investors in the fund, and you're concerned that there's going to be circumstances where you, not the fund manager, are going to be providing information to the investors regarding valuation which then would not be covered by that carve-out.

MR. KASWELL: The fund manager will be providing information to the fund, but the fund is just, it's an entity. So the question is if it provides that information to investors in the fund or to potential investors in the fund, is that covered by the --

MR. CANARY: So this would be not the valuation information going to the fund, but now the fund has that and you're providing communications to your investors, and that's what you're concerned about?

MR. KASWELL: Yes, in a sense. It's the

manager who's going to do the calculations. It's not some -- you know, I mean, they may use third parties to help them prepare that.

MR. CANARY: And when you cross over to the definition, that information has to be in connection with a specific --

MR. KASWELL: That's right.

MR. CANARY: -- transaction or recommendation. You're saying those two you think are not especially clear.

MR. KASWELL: And the net effect is people being cautious, who will say sorry, I can't give it to you.

MR. CANARY: Okay. So let's go to the seller's exception for a second. So what's the investing population that you want to be covered by the seller's exception that are not covered now?

MR. KASWELL: Okay. We want the seller's exception to cover -- you know, we have to remember that my constituency are private funds and sophisticated investors and we think those people should be covered, whether it's in a plan, a fund of one, a traditional hedge fund or, you know, in any of those circumstances, if those people were in an IRA, which also can include those investments. And we think that the relationship in that setting is different from the traditional retail investment where you come in and you say well, let's look at your situation, let's make some assessments.

We're selling, you know, the hedge fund industry is selling a product in the same way that IBM is selling its shares in secondary offerings. And so it then becomes the obligation of the purchaser to make the assessment, ask lots of questions, which is why you get those kinds of memoranda.

And, you know, the idea is that the investor is making those determinations based on its own evaluation, but it's not a sort of here's a product, I have a fiduciary relationship with you because I know who you are, I know how old you are, I know how much money you make, and therefore this is a good product for you. That's just not the dynamic that goes on in the hedge fund business.

MR. CANARY: Okay. Maybe I'll just have to review the comment letter a little bit more, because I'm thinking your average participant or beneficiary in a 401(k) plan isn't going to be investing in a hedge fund.

MR. KASWELL: That's correct.

MR. CANARY: And that it's going to be the institutional investor or a larger plan. I was wondering whether you were concerned about the 100 participant plan threshold, you end up with plans with 50 participants investing in a hedge fund and that's what you're concerned about, or whether it's an IRA investment market where you potentially could end up with a sophisticated investor and a significant holdings in IRA that would be looking to access hedge fund investments.

MR. KASWELL: I mean, the individual investor in the plan has to meet the threshold. If the whole plan meets it, that's not good enough.

MR. CANARY: Fair enough. That's why I think you're probably not talking about participants and beneficiaries in a typical 401(k) plan investing in a hedge fund.

MR. KASWELL: That's right. When I heard the numbers about the average size, that doesn't get you in the door. And we like it that way because we are not a retail industry. Retain entails tremendous amounts of protections, appropriately so. In the hedge fund industry, you don't get to invest unless you meet those minimum amounts which are significant.

MR. KASWELL: All right. Thank you.

MR. KASWELL: Thank you.

MS. MARES: So, Mr. Kaswell, maybe I can ask you some of the same questions. You talked about sophisticated investors, accredited investors, qualified purchasers. Could you give us the parameters that define that so that we can understand clearly the type of investor that you think meets the standards for the type of product you're talking about?

MR. KASWELL: Sure. One of the things to think about is how do we get to these numbers, okay? The history here, in the securities laws, there are public offerings, of course, where the public needs the protection of basically the SEC saying you need to have this information available to you because you probably don't know the right questions to ask and even if you did you wouldn't get your question answered. And so the SEC says we're not going to tell you whether it's good or bad, but we want to make sure that you have the full complete information, okay? That's the public offering, which we all know.

The private side, which is, you know, just as old, says for the sophisticated investor you can fend for yourself. You know, pick an easy example. You're Warren Buffett. You have very deep pockets, and that's the first prong of sophistication. And the second is that you can withstand risk. The test is the double sophisticate standard, which doesn't mean you know which wine to order and which fork to use. It means that you have the financial depth and the acumen to be able to ask these questions.

The problem with that standard is it's fairly easy to articulate, but in practice it was hard to put into effect. So 30-something years ago the SEC adopted rules and said here are the rules and if you trip over these that means that it's not a perfect proxy for sophistication, but it's a pretty good one.

So what's the first one? The first one is under Reg D an accredited investor, so a million dollars in assets, recently excluding residence, and income of $200,000 in each of the two most recent years or joint income with that person's spouse in excess of $300,000. Now that's the bottom rung, okay? But that's probably a 3(c)(1) fund.

But for a 3(c)(7) fund, the threshold is higher than that. That's the qualified purchaser standard. It's $5 million in investments for individuals and $25 million for entities such as pension plans.

Then there's a third test, the qualified client, and in order to charge a performance fee you have to trip over that. And so that amount is a person whose net worth is at least $2 million or $1 million managed by the advisor.

And so where does this all lead you? You know, Dodd-Frank has urged the SEC to take another look at these numbers and we hope they will, but I think one thing that's important to realize is it does have the effect of screening out the average retail investor. You're in the stratosphere basically on a statistical basis.

MS. MARES: Thank you.

MR. HAUSER: I'm trying to experiment with not asking any questions, so thank you all very much. I appreciate your time.

(Panel switch.)

MR. HAUSER: Whenever you all are ready.

MR. ROBINSON: Do you want to do alphabetical order again? Does that work? Okay with you guys?

MR. HAUSER: Okay.

MR. ROBINSON: All right. Well, first of all, thank you for the opportunity to on behalf of the Appraisal Institute testify. We are the world's largest association of real estate appraisers. My name is Scott Robinson. I am the 2015 President-

Elect. I also have with me today Bill Garber, who is our Director of Government and Industry Relations. We certainly appreciate your tenure in this process and also your attention to all the input that you've been able to get.

Real estate appraisals play an important role in protecting pension plans that invest in real estate. Appraisals prepared by designated members of the Appraisal Institute and other valuation professionals are frequently used for financial reporting purposes. Such appraisals are prepared on a quarterly or annual basis with such information frequently included in financial disclosures. We appreciate the consideration that has been given to our input on this type of appraisal service.

Another way that pension plans may use appraisals is when deciding whether to purchase or sell assets or when investments are moved into and out of plans. While we agree with the general intent of the proposed rule, we remain deeply concerned that the proposal will unnecessarily increase costs on consumers and users of appraisal services in important buy and sell decisions relative to plan investments.

Specifically in its proposed rule the Department has exempted the former from the proposed fiduciary standard but retains the inclusion of the latter, meaning an appraisal firm who does financial reporting of appraisals for a pension plan would not carry a fiduciary responsibility, but one doing appraisals for buy/sell decisions would be considered as a fiduciary.

Under the proposed rule, we could also see investors claiming that an appraisal for a loan, say to an LLC that served as the investment vehicle for a 401(k) or IRA investments, was in connection with the transaction.

The proposed rule as is clearly increases liability on real state appraisers and at the worst time when the profession already faces challenges in attracting the next generation of valuation professionals through overregulation.

Our concerns stem primarily from the lack of distinction between appraisals prepared for investment managers and fairness opinions. These two are completely different services with their differences being central to questions about responsibilities to plan investors.

Specifically, this proposed rule confuses the role of appraisals in buy and selling decisions as the role of fiduciary is maintained by the investment manager, not the appraiser.

The investment manager considers the appraisal and compares that with other information, such as offers made on the property, to make determinations in the best interest of the fund. The appraiser does not carry that responsibility or decisionmaking authority and contrary to the proposed rule performs such work in accordance with generally accepted appraisal standards without advocacy to the client or conflict of interest.

This mandate is specifically addressed in both the USPAP ethics rule -- Uniform Standards of Professional Appraisal Practice rule -- and the Appraisal Institute's Code of Professional Ethics.

Once the appraiser has completed the valuation assignment fairness opinions may then be developed by the investment manager or a third party who holds the fiduciary decision responsibilities regarding the transaction.

The current version of the proposed rule mentions appraisals and advice in the same sentence. It is not the role of the appraiser to advise the client. The role of the appraiser is to provide their client with information that can be analyzed for the purposes of use of that asset within the plan.

An example of an unintended consequence of this proposal is found within the fact that a key part of any appraisal is identifying the intended use and the intended user of the appraisal. The intended use and intended users gives the appraiser the ability to develop a scope of work appropriate for both.

This proposal would create a potential unlimited number of intended users of the appraisal. This casts a wide net of liability onto the appraiser.

In contrast, fairness opinions differ vastly from appraisals as they essentially represent the work an investment manager might perform as a third party. Fairness opinions answer a different question than appraisals. While appraisals may provide information to an investment manager or answer whether the value of the property is within a stipulated range or price, it does not answer the question as to whether the price or the terms are fair. Such opinions can be offered by real estate appraisal professionals, but such advice would be beyond an appraisal.

This is an important distinction that is currently not found in the proposed rule but is essential to any final rule.

We have consulted with professional liability insurance providers to the appraisal profession and such a change will likely compound the difficulty in finding coverage for this type of service or result in increased costs for valuation firms providing these services. Most insurance policies to appraisers exclude ERISA related claims, so coverage is difficult to obtain already.

While plans such as those endorsed by the Appraisal Institute do include coverage for this, we expect that the increased liability created by the proposal would have a corresponding effect on those insurance costs.

Unfortunately, this will likely cause some to reconsider providing such important services altogether. We believe this is needless and unnecessary as the Department of Labor has still not provided evidence for why appraisers should be covered under the fiduciary definition. To our knowledge, the Department of Labor has not attempted bringing enforcement actions against real estate appraisers and has not explained how the process will be weakened by the lack of fiduciary coverage.

Further, the real state appraisal profession has an ever-present regulatory structure where public interests are actively protected. In fact, real estate appraisal is one of the most highly regulated professions in financial services through state licensing and certification and federal oversight just to name a few.

Valuation professional organizations such as the Appraisal Institute maintain active ethics and standards enforcement. In contrast, the realm of fairness opinions is less defined and not subject to regulations similar to that seen in the real estate appraisal profession.

We urge the Department of Labor to resolve these concerns by undertaking two specific actions in any final rulemaking. First, provide clear definitions for appraisals and fairness opinions; and two, provide an exemption for appraisals prepared for specific transactions involving the acquisition, disposition, or exchange of real estate. Doing these would distinguish fairness opinions, whether provided by appraisers or others, as carrying a fiduciary responsibility, a position that is reasonable given the purpose of the fairness opinion.

I want to thank you again for the opportunity to testify. I'd be happy to answer any questions that you may have. And we are offering to provide any assistance as the Department works towards maintaining a higher level of quality in the appraisal product used in this business. Thank you very much.

MR. HAUSER: Thank you.

MR. NICHOLAS: Go in reverse order?

MR. GERBER: Sure.

MR. NICHOLAS: All right. Good afternoon. I'm Mike Nicholas, CEO of the Bond Dealers of America. I'd like to thank the Department of Labor and its staff for the opportunity to testify today.

The Bond Dealers of America is the only DC-based trade association exclusively representing middle market and regional securities firms and banks active in the U.S. fixed income markets. A core mission of the BDA since our founding in 2008 has been investor education and protection and fostering competitive capital markets that benefit all participants.

Through our previous comment letter and today's testimony I'll explain why the BDA does not believe the proposed rule or the associated exemptions represent the right approach for improving the market for retirement investment advice and services.

BDA believes the proposal naturally favors an investment advisory business model over a commission-based brokerage model. Therefore, the BDA does not believe the proposal as written is in the best interest of investors because it will reduce investor choice and access to advice. Yet we do believe, as others have testified and commented, that there are more suitable solutions that will achieve the DOL's objectives to create an enforceable standard.

To start with, the BDA encourages and supports a harmonized, multi-agency approach in which the DOL and the SEC develop a uniform best interest standard of care. The Department's proposal would create differing standards for care for retirement and non-retirement accounts that would ultimately confuse the overall advisor/investor relationship.

As Janney Montgomery Scott states, the proposal will create "three standards of care applicable to investment accounts: one, a FINRA suitability standard; two, a fiduciary standard for advisory accounts operating under the SEC's Investment Advisors Act of 1940; and three, a DOL promulgated ERISA fiduciary standard of care for IRAs. We question whether that outcome makes sense for retirement investors." The BDA agrees.

BDA supports a harmonized best interest standard of care for broker-dealers based on the following principles:

Disclosure of conflicts. Advisors should disclose material conflicts of interest to investors and obtain acknowledgment and consent of conflicts related to a recommendation.

Disclosure of fees. Require firms to develop policies and procedures to govern the clear disclosure of fees.

Three, disclosure related to principal transactions. Allow advisors to recommend securities out of inventory only if accompanied by disclosure to the customer of the conflicts associated with principal transactions, rigorous enforcement of the best interest standard of care.

Additionally, BDA strongly favors vigorous enforcement of the recommended uniform best interest standard of care so that bad actors are effectively sanctioned and deterred from wrongful conduct and investors have the ability to recover losses due to a violation of the best interest standard.

Second, the BDA believes the best interest exemption is not in the best interest of investors for the following reasons:

The proposed legal liability associated with the proposed definition of fiduciary and the best interest exemption will make commission-based advisory business economically and legally impossible for broker-dealers. As Raymond James notes in their comment letter, "Given the uncertainty of financial markets, the odds of an alternative perhaps lower fee product outperforming the selected product are quite high. This makes plaintiffs' attorneys cases significantly easier. Our potential legal exposure will increase exponentially if the recommended products cost more than a possible alternative."

Additionally, the best interest exemption unnecessarily restricts the assets available to retirement investors. Investors cannot transact in taxable or tax-free municipal bonds under the terms of the exemption and brokers cannot earn commission related to a municipal bond transaction under the terms of the general rule.

Ultimately the impact of the best interest exemption is that advisors will feel compelled to either recommend the lowest fee investment no matter what or to shift from brokerage accounts to more expensive fee-based accounts.

As Stifel CEO Ron Kruszewski stated, moving non-managed IRAs to Stifel's advisory program would cost those investors in excess of $150 million annually in increased fees.

Third, the principal trading exemption explicitly restricts investor asset choice and ignores the existing broker-dealer regulatory regime. The BDA believes that the assets listed in the principal trading exemption are too limited. The exclusion of taxable and tax-free municipal bonds, unit investment trusts, CDs and non-agency mortgage backed securities are especially problematic. BDA believes that advisors should be permitted to recommend securities out of inventory if the advisor discloses the conflicts inherent in principal trading to the investor as part of a harmonized best interest standard of care.

Finally, the exemptions requirement to get two comparable quotes for a principal transaction ignores existing best execution standards for which broker-dealers execute transactions at the best price possible given market conditions. The two quote requirement would unnecessarily slow the trading process down and may not result in transactions at the best possible price for investors.

The BDA agrees with Wells Fargo's comment letter where they state, "We believe the Department's assumption that it will only take five minutes to get two quotes based on our experience is faulty in many instances and that retirement investors will be harmed if they are forced to wait the duration of time it will take to accumulate the necessary information."

BDA believes a uniform, harmonized and rules-based approach based on existing best execution standards is the most logical standard for the Department to follow.

In conclusion, the BDA understands the need for the Department to fortify the rules applicable to retirement investors and investment recommendations. However, BDA believes that the Department's approach is not in the best interest of investors, especially investors with fewer resources for retirement savings.

As stated above, the BDA urges the Department to act in concert with the SEC in order to best protect all investors by designing a harmonized best interest standard of care and expanding the universe of permissible investments.

As FINRA notes, "A best interest standard would align the interests of intermediaries with those of their customers, better protect investors by providing a more consistent set of obligations across financial service providers, help ensure that intermediaries eliminate or manage conflicts of interest, and help ensure that intermediaries establish an ethical culture throughout their firms."

The BDA agrees. Thank you again for the opportunity to deliver these remarks.

MR. HAUSER: Thank you.

MR. GERBER: Good afternoon. My name is Mike Gerber and I'm the Executive Vice President at Franklin Square Capital Partners. We appreciate the opportunity to participate today.

Franklin Square shares the Department's goals of increasing retirement savings for all Americans and protecting investors in all retirement settings. We applaud the obvious care and thoughtfulness that went into the preparation of both the proposed conflicts of interest rule and the best interest contract exemption, which today I'll just refer to as the proposed exemption.

Today I'll offer a narrow technical change to include non-traded BDCs on the list of eligible assets in the proposed exemption and explain why we believe this change is consistent with the objectives of the Department.

Before I get into the details I'd like to spend a few moments telling you about Franklin Square and our funds. Franklin Square was founded in 2007 in Philadelphia. Our mission is to enhance mainstream investors' portfolios by providing access to asset classes, strategies and asset managers typically available only to wealthy individuals and institutional investors, such as university endowments, foundations and public pension plans.

We also strive to lead the industry in best practices, transparency, investor protection, and education. To that end we launched the industry's first-ever non-traded business development company or BDC in 2009 which we listed on the New York Stock Exchange in April of last year to provide permanent liquidity for our investors.

Today Franklin Square manages four BDCs, both traded and non-traded, and has more BDC assets under management than any other manager in the industry. By way of background, BDCs are a type of closed-end investment company created by Congress under the Investment Company Act of 1940 to enable mainstream investors to invest in and in turn increase the flow of capital to private and small public companies in the United States.

At Franklin Square we also manage one closed end registered investment company which is also a 1940 Act fund, and we have two additional non-traded BDC funds currently in registration with the SEC.

Our investors hail from all 50 states and our funds have portfolio companies in 39 states. Most importantly, our funds have a record of delivering strong risk-adjusted returns for our investors.

At Franklin Square we believe our funds embody the principles of the proposed rule and have initiated positive trends in the industry. By offering a combination of strategies and investor protections never before offered to mainstream investors, we disrupted the marketplace and have emerged as a leader.

While we are democratizing investing we are also delivering heightened investor protections, best practices, and more robust education. This is at the core of our identity and our business strategy. Nearly 200,000 investors have voted with their feet, choosing our more transparent and investor protected funds over those previously available in the marketplace, such as the non-traded REITs. As a result, we now see competitors launching similar funds emulating some of our heightened investor protections, best practices, and education programs.

We believe the Department can accelerate these positive changes we have initiated by including non-traded BDCs on the list of investments defined as assets under the proposed exemption. This can be accomplished simply by replacing the phrase registered investment companies with the phrase investment companies regulated pursuant to the Investment Company Act of 1940 in Section 8(c) of the proposed exemption. A markup to the text of the proposed exemption is provided on pages 1 and 2 of our comment letter.

By amending the proposed exemption in this narrow manner only non-traded BDCs would be added to the list of eligible assets and registered investment companies would remain on the list.

We believe this change is consistent with the spirit of the proposed rule for two reasons. One reason is that non-traded BDCs are among the most highly regulated and transparent investment vehicles in the marketplace. Like registered investment companies and traded BDCs, both of which are covered by the proposed definition of asset and both of which we manage at Franklin Square, non-traded BDCs register shares under the Securities Act of 1933, elect treatment as a BDC under the 1940 Act, and are subject to the extensive public filing requirements of the Securities Exchange Act of 1934.

Beyond this, however, non-traded BDCs must also comply with state Blue Sky laws, meaning they register their offerings under the Securities Acts of each state. Registered investment companies in exchange traded securities like traded BDCs do not. In other words, non-traded BDCs are more heavily regulated than many types of investments already included in the proposed exemption.

I would also like to note that at Franklin Square we go above and beyond these statutory requirements with our own best practices which I'd be happy to discuss during our Q&A session as those best practices could be embedded in the proposed exemption to further protect investors.

The other reason this change is consistent with the Department's efforts is that non-traded BDCs meet the four criteria set forth in the proposed exemptions preamble.

First, as I just discussed, non-traded BDCs are subject to robust disclosure requirements under the federal and state securities laws that collectively provide investors a high level of transparency.

Second, non-traded BDCs can be an important part of a well diversified portfolio because they (a) primarily lend to private companies; (b) often deploy capital when other investment vehicles cannot; and (c) have an offering price tied to their net asset value which offers some protection from market volatility.

Third, non-traded BDCs have a ready market price established through valuations conducted in accordance with the 1940 Act and publicly disclosed at least quarterly.

Finally, while non-traded BDCs are initially less liquid than publicly traded securities, they are designed to provide full liquidity to investors through a permanent liquidity event, such as a listing on a national securities exchange. Additionally, non-traded BDCs provide limited liquidity prior to this permanent event through quarterly tender offers.

For the reasons discussed today and in our comment letter Franklin Square respectfully requests the Department include non-traded BDCs as an eligible asset in the proposed exemption. This change would be consistent with the objectives of the proposed rule because non-traded BDCs are among the most highly regulated investments available in the marketplace and because they meet the Department's criteria for inclusion in the proposed exemption.

Franklin Square believes that having a robust proposed rule in place coupled with a practical proposed exemption that includes non-traded BDCs will protect investors while allowing them to build well-diversified retirement portfolios. Thank you again for allowing us to participate today and I look forward to answering your questions.

MR. HAUSER: Thank you.

MR. CAMPAGNA: I just had a couple questions for Mr. Robinson.

You talked a lot about the difference between fairness opinions and appraisals and it seemed to be that you are characterizing fairness opinions as those that are considered or put out by the investment manager. Is that the only situation that the idea of a fairness opinion is used where appraisals are presented to an investment manager and they create the fairness opinion? Is that the -- so you asked us to create a definition. Is that -- I'm just trying to get the --

MR. ROBINSON: Yeah. And I don't know if this is on -- the difference between the appraisal and the fairness opinion we believe is fundamentally based on the fact that the appraisal is presented as a piece of market value evidence which then whoever is producing that fairness opinion uses in their total decision. Now that does not mean that an appraiser cannot step out of the realm of the appraiser and provide additional services that may step into a realm that puts them in the fiduciary position, but we believe fundamentally that the real estate appraisal as it stands on its own is again a piece of information that the manager or whoever is making that fairness opinion uses in their final decision.

MR. CAMPAGNA: Well, it's a very important part of our rule that appraisals are very influential in making these decisions. So how is it different in this particular context where the investment manager is presented with appraisals and makes a decision even though what you characterize as their decision is a fairness opinion? It's still the kind of model we thought of, is that an appraisal presented to a plan fiduciary is a very influential piece of information and that's why.

MR. ROBINSON: No doubt, and we certainly believe, you know, the existing rule captures it in some ways and certainly the removal of that in the current proposal we appreciate for the opportunity to have that taken out for reporting for financial reporting on an annual or quarterly basis. But we believe that the appraisals used in transactions again are a piece of stand-alone information that whoever is producing that opinion will then take at face value.

They may not. They may order another appraisal. That's the other issue. The fund manager is not in any way prohibited from getting more than one opinion. And again, this is an opinion from a real estate appraiser as to the market value of that property.

And as I stated, our ethics rules, both our ethics rules internal to the Appraisal Institute and those set forth by the uniform standards, require independence, require a lack of advocacy or bias, and so we believe that the appraiser is in a unique position to stay out of that realm unless, again, they choose to go into the next area and put themselves in a fiduciary position.

MR. CAMPAGNA: Is it often the case that an investment manager will just use one appraisal? What does the --

MR. ROBINSON: I can't speak to that because, again, they are using the best information they have. Hopefully they're using appraisers that have a reliable reputation for that property type and that location. Certainly competency is a big issue in the determination of hiring that appraiser, and we believe that it's that independence and that credibility that the fund manager believes in as they gather that piece of information to make a decision for the fund.

MR. CAMPAGNA: Just one more question. You mentioned the need for an exemption. Could you describe what the particular prohibited transaction you have in mind would be? You're right, we're talking about an appraisal -- appraiser as a fiduciary.

MR. ROBINSON: Right.

MR. CAMPAGNA: But what is it exactly that they're doing that would influence their fees or cause themselves to get --

MR. ROBINSON: Well, again, it casts a wide net of liability if the intended users go beyond a specific client. In other words, if the client definition includes all the potential investors in that plan, then that casts a net of liability that most appraisers and a lot of the insurance companies would look unfavorably to.

We've asked specific questions to this issue to our -- the plan that we endorse and they do say that this would be a wider net of risk. And I think there's also maybe a public misperception about where we are right now. That risk may already be there, but the proposed plan has taken out part of it, and we would like to take out the remaining part of it.

MR. HAUSER: Understood. Can I just ask, and this is maybe as much out of curiosity as anything. So, if you're a reasonable investor, what are the circumstances in which you'd want a fairness opinion rather than an appraisal? I mean, why would one ever get anything other than an appraisal?

MR. ROBINSON: I guess I don't understand the question because a fund manager would be developing the fairness opinion of the appraisal and it's, again, we believe a small part of the overall decisionmaking process. So would you want an appraiser to say okay, here is the market value and here is what we believe is fair to that investor? Those are two different questions because fairness to the investor may have a significant number of deeper decisions based on the plan's anticipated growth model, whether it's a tax-based plan. There are a number of items that may put that appraisal not necessarily into a clear definition as to the final decision that's made. So fairness goes way beyond the opinion of market value in our opinion.

MR. HAUSER: But you would never view the fairness opinion as a substitute in any sense for the appraisal, I mean, if you're looking at a transaction that involves, you know, a non-publicly traded asset I guess. Is that right?

MR. ROBINSON: No. We believe that an important part of the fairness opinion is a qualified appraisal on the property, done in a credible manner by someone who understands the market and the property.

MR. HAUSER: Yeah, I understand. Thank you.

MR. COSBY: I had a question for Mr. Robinson. In your comment letter you had testified that you had talked with insurers in your business and they had indicated to you that there could be increased costs due to these issues that you're talking about. I just wonder if you can elaborate on that and maybe just talk a little bit about the insurance market in your industry.

MR. ROBINSON: Yeah. Well, appraisers liability insurance is incredibly difficult to get in a lot of areas already and relative to ERISA-based opportunities it can be even more difficult already.

There's a fundamental part of an appraisal where you must identify the intended use and the intended users of the appraisal, and those two things help the appraiser determine a scope of work that answers the questions and meets the needs of both that intended use and of all those intended users. And when you have this inclusion in these particular transactional situations of the appraisal report and the fiduciary position, what you essentially have done is put an unlimited number of potential users out there, which enhances the liability exposure that the appraiser has for the work product he's providing to the plan manager or the developer of the fairness opinion. And that's where the insurance companies latch onto it because the possibility for any kind of litigation or additional liability is expanded dramatically.

MR. COSBY: And I had a question for Mr. Robinson -- Mr. Nicholas, I'm sorry. You had mentioned, you talked about policies and procedures that you were in favor of.

MR. NICHOLAS: Right.

MR. COSBY: And as I understood it, most of those policies and procedures seem to be more or less disclosure-based policies and procedures. And as you know in working on the rule we found a lot of literature that's shown that disclosure is not necessarily effective. So my question was one major purpose of the rule is to try to tamp down on the conflicts of interest, so I was wondering what type of policies and procedures in your experience you think would be effective in doing that.

And then I was hoping that you could maybe, you said that your company has effective procedures that have been working, so I was just wondering if you could expand on that as well.

MR. NICHOLAS: Sure. Well, I'll start off just by ticking off some of the suggestions we make actually in our comment letter.

First is fee disclosure. As part of fee disclosure, you know, specifically ensure the receipt of fees and commissions does not trigger a violation of the best interest standard of care, thereby restricting the flexibility of investors to receive advice and choose from a wide variety of securities that may suit their investment needs or restrict the provision of financial advice in general.

Second would be a conflict of interest disclosure as you just highlighted. Requiring disclosure and consent at account opening. Prominently display the conflict disclosure on the website, require disclosure and confirmation of consent annually through company-based web disclosure or at the client's request via delivery of hard copy material.

Third is principal transaction disclosure, disclosing the conflicts generally at account opening, referring to the trading, the inherent conflicts of trading out of inventory versus as agent. And disclosing the conflicts of pre-trade by settlement on a principal transaction and require pre-trade consent by the investor. Next is preserve investor choice and last is cost/benefit analysis.

MR. COSBY: Yeah. I was more focused on like internal controls. I don't know what type of mechanisms there might be because this is kind of putting the onus on the investor to actually go through the disclosures and figure some of this out. So that's what I was focused on. I don't know, Mr. Gerber, if you had any suggestions in that area.

MR. GERBER: Yeah, and obviously slightly different space that we're in, but when I was referring to what I think you were referencing was my reference to our best practices that go above and beyond what's required of us in the '40 Act. That doesn't necessarily touch the relationship between an advisor or broker and an investor. It's germane to how we structure and run our funds, but they do provide further investor protections.

So, in our case, there are three best practices that I would highlight that go above and beyond the '40 Act, and one is that while we're not required to, we use third-party valuation firms to value the assets in our portfolios. We believe that just helps investors have greater confidence in the information that we are providing.

Also above and beyond the '40 Act we mark every investment in our portfolio every quarter. The '40 Act does not require that. The '40 Act requires that you mark every investment once a year. So the standard practice for BDCs is to mark 25 percent of the portfolio every quarter so you get 100 percent over the course of a year. We do 100 percent every quarter using those third-party valuation firms.

And lastly, it's our commitment not to overdistribute, and that's a feature of our funds that we use to distinguish how we manage our funds from those that were in the marketplace before we were, particularly the non-traded REITs. Overdistribution is a fairly common practice with non-traded REITs. We structure our funds so that we don't have to do that. We think it's in the best interest of our investors for obvious reasons not to do that. So those would be the three better practices that I was referencing.

MR. COSBY: Okay. Thank you.

MR. GERBER: Yes.

MS. MARES: So can I follow up on the notion that I appreciate that you mark your portfolio to market every quarter, because I understand that there are provisions to facilitate some liquidity in the portfolio through those quarterly valuations.

For those that don't mark, if it's not a requirement to mark to market every quarter and there is this option for quarterly redemptions, what's the risk that the valuation is inaccurate?

MR. GERBER: You know, I can't speak to how the other folks run their funds, but we engage in that practice in part because we do think it would result in our achieving a more accurate price at those quarterly redemption periods.

So, in our case, and again I can't speak to our competitors, but in our case, we base those redemptions on what we call the POP, the Public Offering Price, and that's tied to the net asset value, and the net asset value obviously is tied to those marks. So we're using third-party firms to help establish those marks. Our independent directors are approving those third-party valuations or at least the process through which the third party and our staff achieve, reach those valuations.

And then those valuations contribute to the calculation that we engage in every day to establish net asset value. And then it's based off of that net asset value that we get to the public offering price. So it's a pretty long continuum, if you will, and a lot of steps in there, but we believe that helps us get to a more accurate price. So, when one of our investors does seek to redeem some shares, it's being done at a price that's very closely tied to NAV and is based on that elaborate robust process.

MS. MARES: So a previous witness told us that there were traditionally discounts that come at the redemption period to that asset value that you created. Could you describe what your practice is and how you think through that liquidity event?

MR. GERBER: Yeah, and if I'm not mistaken, I think that previous witness was talking about non-traded REITs, not about non-traded BDCs. The rules governing the two types of funds are very different, primarily because we're '40 Act and they are not. So I don't want to compare those processes.

MS. MARES: Okay.

MR. GERBER: We believe ours are far more robust and it's partly how we've marketed ourselves in the marketplace as having more investor protections, more transparency, and part of that does come from the fact that we strike a NAV, a net asset value, every day and that's based on those marks that we establish every quarter and then any fluctuations with our more liquid investments that are in the portfolio. And that way at the end of every week we're able to do an analysis which at the end of every week is when we clear the transactions. We believe we can reach a very accurate price by doing it that way.

I can't speak to the discounts that he referenced in the non-traded REIT context, but in our context it's based on the public offering price, which is tied to the NAV. Now it is less any distribution fees that an investor would have paid at the time of the transaction. We have investors that come into our funds through brokers who charge a commission, through advisors that charge a wrap fee, through RIAs, a whole host of intermediary types, and so it depends on the individual investment. We offer it at that public offering price, which is tied to the NAV.

MS. MARES: You mentioned that your third practice was not to overdistribute. For those of us who don't understand that technical term, could you describe what that means?

MR. GERBER: Sure. So funds of different types, REITs, BDCs, bring capital into the fund in three ways: investor capital, the investment that an investor makes; borrowings, leverage that's brought in from a bank; and then investment returns. That's how you accumulate the assets in a fund, and then you go deploy that capital over time in different investments.

Overdistribution is the concept of paying a distribution or a dividend to an investor using offering proceeds or the investor's capital or leverage that's brought in from a loan as opposed to just using the proceeds of investment returns to pay the distribution. And that's a practice that's been in the marketplace for years, particularly in the non-traded REIT context, and that's something that we at Franklin Square committed not to do.

Now, under the '04 Act, BDCs are not able to do that unless they disclose where those distributions come from. And so technically you could argue that under the '40 Act BDCs are permitted to do it, but we go above and beyond that with our best practices and commit to not doing that.

MS. MARES: So take me through the development. You borrow money, you create this offering, investors invest in your fund. At the time of initial investment are there any investments that are specified? Do they have -- you have a strategy?

MR. GERBER: Right.

MS. MARES: But do they actually see any investments at the time they --

MR. GERBER: Well, maybe.

MS. MARES: Okay.

MR. GERBER: And let me tell you why I give you that answer. In our case, yes, because one of our other better practices at Franklin Square is to make a significant what we call sponsor commitment. So we invest our own money in the funds and we get the funds launched with our own money. We believe, although it's a different conflict than what you're driving at with the rule, in our case, we believe that aligns our interests as the manager with the interests of the investor. So yes, there are some initial investments that are made as we're out raising money from our early investors, but like most investment funds that are in their early stages, the investors don't know once the fund is fully ramped what investments will be in that fund. But they see, they can see some of the investments that we've already made. But not all BDCs are required to do that, make that sponsor commitment, so that's why I said maybe. It's not across the board.

MS. MARES: And so my understanding is that you have a couple layers of fees that are part of your structure.

MR. GERBER: Yes.

MS. MARES: I wonder if you could talk about those.

MR. GERBER: Sure. So the management fees that come with investing in our funds come in two forms. There's an asset management fee and then what we call the incentive fee. The incentive fee is not required, but again, we believe that aligns our interests as the manager with the interests of the investor. Those are the fees that we charge to manage the fund.

When we launch our funds, they're in a traditional what's called 2 and 20 structure, so it's 2 percent of assets under management and then 20 percent on the incentive fee after we've reached our hurdle. In other words, we return a certain amount of the investment earnings to the investor before we participate in the upside. And we've led the industry with high hurdles which are in the best interest of the client. So those are the asset management fees.

On the distribution side, there are fees as well, but that's determined between -- we don't determine that at Franklin Square as the fund manager. That's something that's established between the investor and the intermediary with whom the investor is working. So it could be a broker, it could be an advisor, could be an RIA, and they all have different fee structures.

MS. MARES: But it's paid out of the investor's assets that are --

MR. GERBER: Yes, the investor pays those fees, whether it's a commission up front or an ongoing wrap fee. That's borne by the investor.

MS. MARES: So, when you think about the structure, it has some unique characteristics. It's long-term. It's generally illiquid. You may or may not have the opportunity to exit before a public offering or the conclusion of the --

MR. GERBER: Well, you do through the court of intenders, but it's limited.

MS. MARES: Right.

MR. GERBER: I don't mean to interrupt you, but if I could just speak to that point.

MS. MARES: Sure.

MR. GERBER: Again, that's something we introduced to the marketplace that was an improvement over what was previously available. The average non-traded REIT was offering anywhere from 3 to 5 percent per year. We came in and we doubled it or more than doubled it and we offer 10 percent. So that again was an improvement that we introduced to the marketplace in the form of a greater tender opportunity. I didn't mean to interrupt you. I just wanted to make that point.

MS. MARES: Yeah. So you offer some liquidity through the tender opportunity.

MR. GERBER: Yes. That's why we refer to it as limited liquidity.

MS. MARES: Right. Right. So it strikes me that this investment while different than publicly traded stocks and bonds may have some unique, because of its unique characteristics, may have a unique investor. And when you look at are there certain minimum criteria that you have for your investors, how do you think about that?

MR. GERBER: Yes. So that's a great point. So first and foremost we know illiquidity isn't for everybody, so that is a discussion that we think ought to take place between an investor and the investor's advisor. But we do believe that illiquidity has a place in retirement accounts. Retirement accounts are designed to be long-term savings accounts, and there are benefits that come with illiquidity which I'm happy to talk about if you'd like. But would you just remind me the --

MS. MARES: So let me go back and reframe my question. One of the things in considering the assets that are covered under the best interest contract is whether or not they all have similar characteristics. And if they have different characteristics, should there be some unique conditions that go along with those unique characteristics?

MR. GERBER: Got it. Got it. Thank you.

MS. MARES: So I'm trying to get to whether we should think about any unique conditions.

MR. GERBER: Yes. In our previous meetings with the Department and with OIRA we offered some suggestions around better practices that could be tied to funds like ours that carry with them characteristics such as illiquidity. So certainly while we provide limited liquidity during the life of the investment and then ultimately full liquidity through a listing on an exchange, they are different than stocks and bonds that you can buy and sell in liquid markets.

And so we do believe that with that illiquidity there ought to be some other investor protections that are required of the fund or the investment and something certainly that should be considered by an advisor or broker when putting a client into a limited liquidity fund like ours and certainly could be something that could be mandated through the rulemaking process or in the exemption.

MS. MARES: To the extent you have some thoughts as to what those conditions might reasonably be, we'd like to hear them.

MR. GERBER: Yes. We've offered those and I've mentioned some of those today. So third-party valuations, quarterly valuations so you have more current marks, commitments to not overdistribute. And it is a technical term, but there are ways to work out that language. So there are hosts that we've offered. A majority of the board being independent. You know, a lot of our better practices that we've introduced in the marketplace come with the '40 Act, but some of them that I've just mentioned go above and beyond. So we'd be happy to share that list with you again.

MS. MARES: Would you say that the non-traded business development company is an appropriate investment for all IRA investors, or should we consider it to be restricted to a certain set?

MR. GERBER: Yeah. No, I think I would look at it as a choice. So there are benefits that come with the non-traded model and there are benefits that come with the traded model, and it just depends on what's most appropriate for the investor.

And so just to give you a couple of examples. In the non-traded model, we're able to deploy capital through our continuous fundraising model through all market cycles. So we're getting exposure in those funds to deals that those folks in the traded BDC space -- remember we have a traded BDC -- aren't getting exposure because they don't have ready capital. So the portfolio construction within the fund will look different in a non-traded than in a traded over time.

There's the fact that it enables us to invest the underlying assets into which we're investing are illiquid themselves, and so that enables us to get stronger yields for our investors. And then of course there's the fact that it will be less correlated with the market.

But to get those benefits you're buying illiquidity or at least limited liquidity. And so, if you don't want limited liquidity and you want liquidity, you can get that. You can go buy a traded BDC. We prefer that you buy ours. But you can go buy a traded BDC, but when you buy that traded BDC you're not necessarily getting the benefits that the non-traded model offers.

And so they both have benefits and they both have limitations, if you will. So, in our view, it depends on the investor, it depends on how the investor is designing the investor's portfolio and how they want to use that particular type of investment in the portfolio. We would just like for there to be a choice and that's why we're asking that the non-traded BDC be included on the list of eligible assets.

MS. MARES: Do you think an investor's portfolio should have concentration limits as to how much could or should be in a non-traded BDC?

MR. GERBER: Yes, I think there should be concentration limits on any type of investment. You know, I think the idea of putting 100 percent of someone's portfolio in a traded index fund is a terrible idea. That's not to say traded index funds aren't good. It's just to say that if you overconcentrate in any particular type investment it's unwise.

I served for a number of years as a fiduciary for one of Pennsylvania's two large pension funds, a defined benefit fund. I served there for eight years. And if you look at our portfolio construction, it's well diversified. We don't overly concentrate -- we didn't, I should say past tense. I'm not there anymore. But we never would have put 100 percent of the fund in any particular strategy or even 50 percent of the fund in any particular strategy.

So I think that no individual's portfolio should be overly concentrated in any particular type of investment, whether it's illiquid, has limited liquidity, full liquidity, whether it's equities, whether it's fixed income. I hope that over time and through this rule that individuals will be able to construct well-diversified portfolios that perform better than portfolios they've been constructing in the past.

And if you look at the history of individual portfolio construction, you know, when my grandad was investing, his advisor, his broker was saying hey, buy this company, it's a really good company, and buy this municipal bond. We think that that municipality is a good credit. And so you diversified by names and maybe by type.

And then in the '80s we had a proliferation of mutual funds in thousands of varieties. And so people started building portfolios using all these different mutual fund opportunities.

But what's been lacking for all these years is exposure to true alternatives, and that's what we've introduced into this marketplace. And so our view of the world is that ultimately we're going to see individual portfolios being constructed with a certain allocation to true alternatives where folks can benefit from those benefits that illiquidity or limited liquidity present.

But we would never suggest 100 percent of a portfolio should be in our BDC, non-traded BDCs or in any non-traded product. We think that a well-designed portfolio is well-diversified. And so we worry about concentration for our investors, whether it's our funds or any other type of funds.

MS. MARES: So this is just an intellectual curiosity. You mentioned you use leverage in your funds.

MR. GERBER: Yes.

MS. MARES: About how much leverage do you have?

MR. GERBER: Well, that's prescribed by law.

MS. MARES: Okay.

MR. GERBER: And that's another distinction between non-traded BDCs and non-traded REITs. There are no legal limits on the REITs, but in the case of non-traded BDCs, under the '40 Act, non-traded BDCs can only lever up on a one-to-one basis.

To give you perspective, banks that are lenders like our non-traded BDCs are lenders are anywhere from 8 to 15 to 1 right now. Hedge funds that also do private lending like we do have no limits at all. They're in the mid to high teens, maybe even in the low 20s in terms of their use of leverage.

So at one to one, we are extremely low and extremely conservative. And even though we're allowed to go up to one, we don't, and I don't know of any BDC that does because with the fluctuations you could have in a portfolio, you never want to risk being out of compliance, so you're always going to keep some kind of buffer in place. So we are hovering I think in our most mature fund around 80 percent of the leverage that we're allowed to use.

MS. MARES: Thank you.

MR. GERBER: Yes.

MS. MARES: Mr. Nicholas, I have a question for you. I know it seems counter-intuitive that there are times when tax-free bonds earn more than taxable bonds because you'd think it didn't -- shouldn't occur, but I know that it does occur. How often do you think it does occur? Do you have a sense of that?

MR. NICHOLAS: Well, we don't have an actual percentage of time that that occurs, but as you know, the markets move daily, hourly. There are times when the tax exempt security can yield more than an equivalent taxable corporate bond without considering the tax equivalent yield on the municipal. And so you have a lot of examples right now in the current interest rate environment where municipals, tax-free municipals can do very well. And certainly when you talk about, you didn't ask about taxable, but taxable municipal bonds can be a good investment.

One problem we have, one reason I referenced munis, and God bless your grandfather for buying that municipal bond, is that we're concerned about being overly prescriptive with what a retirement investor can and cannot purchase, and limiting that investor to a mutual fund as opposed to a direct purchase municipal bond, taxable or tax free, we just think is inappropriate and there's consequences. There's consequences to what you heard earlier I know from Ron Kruszewski and others about changing business models, securities firms altering business models and the consequences seen by investors. And when you talk about municipals issuers, if you're hampering liquidity in a municipal space because fewer securities firms are buying and holding municipals in inventory, ultimately that hurts the investor through higher borrowing costs and taxpayers through higher borrowing costs.

MS. MARES: Thank you.

MS. LLOYD: Can I follow up on that? I think from your comment you mentioned municipal bonds both for the best interest contract exemption and the principal trading exemption. So they are traded both on an agency and a principal basis?

MR. NICHOLAS: Right.

MS. LLOYD: Okay.

MR. NICHOLAS: Yes.

MS. LLOYD: Okay.

MR. NICHOLAS: You mean generally by securities firms?

MS. LLOYD: Right.

MR. NICHOLAS: Right. Yes.

MS. LLOYD: Okay. And then you talked about our two price quote requirement in the principal transactions exemption and you suggested the FINRA and MSRB best execution rule as sort of a substitute.

MR. NICHOLAS: Right.

MS. LLOYD: So the two quote proposed requirement was sort of to support the notion that we thought you shouldn't trade out of inventory unless you were sure that you could get the best deal. And I'm wondering, is that the result that we'll end up with if we rely on the best execution rules? Can you explain a little bit about that?

MR. NICHOLAS: Well, again, it's about being prescriptive. So there are rules and procedures in place, there have been for a while from FINRA's standpoint and now you mentioned MSRB and municipal execution standards. And the concern is that if the DOL implements very prescriptive rules related to best execution that it will ultimately hamper the investor, because those rules are already in place, you know, the suitability rules, the fair dealing rules, et cetera, are already in place and that ultimately it's being too prescriptive means jumping through artificial hoops, so to speak, and as the market's moving in the question about municipal bonds, as the market's moving you risk giving the investor a price for a security that's not as good as it was 10 minutes ago because of the artificial hoops that are prescriptively being handed down to the BD.

MS. LLOYD: All right. So I guess just to follow up, I mean, if you're following those best execution rules, do you get to the same result, though, that you can't trade out of your own inventory unless you've sort of assured yourself that that's the best deal?

MR. NICHOLAS: For municipals?

MS. LLOYD: Well, I guess is that your area of expertise?

MR. NICHOLAS: Well, I mean, according to the proposed rule, municipals are not part of the --

MS. LLOYD: Right, but --

MR. NICHOLAS: You can't anyway, right?

MS. LLOYD: -- well, that was your suggestion, though, that we include them and then we also --

MR. NICHOLAS: Well, yes, municipals, that we include municipals, right.

MS. LLOYD: Right.

MR. NICHOLAS: Right. So I think you're right. I think you grant investors more options, which benefit -- you know, under current best ex rules, right, which ultimately benefit not only the investors but issuers of municipal bonds if you want to continue talking about municipals as well.

MS. LLOYD: Okay. I'm not sure I

understand, though, fully, though, how the best execution rule works in this context, so maybe we should put aside municipal bonds. Can we talk about the FINRA best execution or is that not something that you're --

MR. NICHOLAS: No, that's fine.

MS. LLOYD: Okay.

MR. NICHOLAS: For corporate, for taxable securities.

MS. LLOYD: Right. So following the best execution rules, will you end up only being able to trade out of your own inventory if that is the best deal? I know you don't have to specifically go out and get two quotes, but I understand that you have to, you know, do some kind of market surveillance. So I'm just wondering if that's --

MR. NICHOLAS: Right, does it force you to trade from inventory as opposed to acting as agent?

MS. LLOYD: Does it only allow you to trade from inventory if that is the best deal? Because that's sort of the result that we want and I just am not clear on how that all works.

MR. NICHOLAS: Right. No, I think that's correct. Yeah, no, I think that the answer is yes.

MS. LLOYD: Okay.

MR. NICHOLAS: I can get back to you on that, but I think the answer is yes.

MS. LLOYD: Okay. Thanks. And then I guess just to kind of finish up, I heard at the beginning that you have a desire for a harmonized multi-agency approach. I wasn't clear on whether your members are comfortable with the enforceable best interest commitment that would be part of both the BIC exemption and the principal transaction exemption.

MR. NICHOLAS: Well, no is the short answer because of the extra steps, the limitations. You know, the BIC excludes, going back to municipals, excludes municipals. And so the short answer is no, we're not comfortable.

MS. LLOYD: Well, I'm just asking specifically not about the whole exemptions --

MR. NICHOLAS: Yeah.

MS. LLOYD: -- because I think we've heard a lot about the workability.

MR. NICHOLAS: Right.

MS. LLOYD: I'm just talking about sort of what we've been identifying as kind of one of the baseline principles of each of those exemptions is an enforceable best interest commitment.

MR. NICHOLAS: Right. No, the answer is no, our members are not. We think it fundamentally changes the broker-dealer business model, which ultimately negatively impacts not the broker-dealer, as you heard earlier today, but the investor.

MS. LLOYD: Why? Why does it -- I mean, just, you know, putting aside the requirements that people have been really worried about --

MR. NICHOLAS: Yeah. It essentially eliminates the commission-based model.

MS. LLOYD: Because you can't act in your customer's best interest in a commission-based -- those two are completely incompatible?

MR. NICHOLAS: It makes the -- as others have said, it makes the legal liabilities too daunting, so that you'll see more and more -- you see this already today, more and more securities firms moving away from the traditional commission model as related to retail and to more of a fee-based advisory approach for retail, to the detriment, as you heard earlier today, to the individual investor.

And I'm not sure if you heard this earlier today, but the other issue with individual investors is if you only have a certain amount of investable funds, you're not attractive anymore to a securities firm that's charging a flat fee unless that fee goes dramatically up. So you're limiting options all of a sudden for individuals that have less than X number of dollars to invest.

MR. HAUSER: So just so we can -- I just want to be clear on what it is that you think is incompatible with the broker model here. So again just focused on up-front commitment, act in your customer's best interest, prudence, fees reasonable in relationship to the services provided, and it's enforceable. And in individual cases, it can be enforced through, you know, FINRA binding arbitration, and in class cases, it would be enforced through class actions. This is also true under FINRA. So which of those do you think is incompatible with a commission-based model or with brokers?

MR. NICHOLAS: Well, the fiduciary standard generally, moving away from a suitability standard, is in conflict with the commission-based approach of a brokerage firm.

MR. HAUSER: And why? I mean, you indicated earlier that you supported a sort of standard that would align the customers' interests with the financial intermediary's interest.

MR. NICHOLAS: Right.

MR. HAUSER: I thought you were quoting Mr.

Ketchum with approval. So why is there an incompatibility assuming that can be done with a commission model?

MR. NICHOLAS: Well, I think the biggest concern with our members is that the fiduciary standard comes with a much higher legal liability, potential legal liability than suitability standards. That makes it incompatible to act in the best interest of your client on a commission basis when many times broker-dealers have a client on both sides of the transaction. They're not just acting like an investment advisor with one -- you know, managing one person's retirement account or estate planning, right? And so for that reason alone it's incompatible with the commission model, which would --

MR. HAUSER: But is it greater legal liability in your mind because you're more likely to be found to have breached the standard or because you think there's some difference in the remedy that's available? I'm just --

MR. NICHOLAS: Well, we just think there's a different legal view of suitability and fair dealing versus fiduciary.

MR. HAUSER: Right. One's a higher standard. And you emphasized, and I know we're eating into the last, and I apologize to all of you four-day folks, but you indicated that you would prefer to manage this with disclosure. Could you just describe, so when you talk about conflict disclosure, what are your firm's conflict disclosures? How do you describe the conflicts?

MR. NICHOLAS: Well, I mean, that's from the outset of the account opening.

MR. HAUSER: Right.

MR. NICHOLAS: And so from the outset and through the process, you know, whether it's certainly trade by trade and then on a monthly basis, highly regulated by the way, our broker-dealers that are members of the BDA are working with clients to disclose any conflict of interest, whether it's training by agent, training by principal, and then all the other risks that are engaged, you know, with the trading of securities, including market risks and interest rate risks, et cetera.

MR. HAUSER: I guess I'm just wondering if you could put a little more meat on the bones there. I mean, what does that look like? Is it I may have a financial interest? What is the conflict?

MR. NICHOLAS: Every firm to meet the requirements and demands of FINRA has best practices in place, so every firm could be different, but meeting the same goal, best practices in place that sends out on a regular basis to the client the potential conflicts of interest, disclosing, you know, whether acting as principal, whether acting as agent, the fees, et cetera, and then verbally that's communicated as well on a regular basis to the client. So I can get you if you'd like, I can get you, you know, real prescriptive information as an example from a typical regional middle market securities firm.

MR. HAUSER: Well, if you send another follow-up --

MR. NICHOLAS: Sure.

MR. HAUSER: -- comment, but go ahead and attach that.

MR. NICHOLAS: Sure.

MR. HAUSER: That would be nice.

MR. NICHOLAS: Sure.

MR. HAUSER: Thank you very much. I appreciate your input.

MR. NICHOLAS: Sure.

MR. HAUSER: Last panel.

(Panel switch.)

MR. HAUSER: Mr. Katz, would you like to start?

MR. KATZ: Sure. Well, good afternoon and thank you very much for inviting me to speak with you today. My name is Gary Katz. I'm President and CEO of the International Securities Exchange, one of 12 regulated options exchanges in the United States. This coming February I will mark 30 years in the options industry, the first 12 at the New York Stock Exchange and the last 18 as a co-founder of the International Securities Exchange, which is the first all electronic options exchange in the United States.

I'm here today representing the U.S. Securities Market Coalition. That group is made up of all 12 options exchanges in the U.S., as well as the Options Clearing Corporation, the clearinghouse for the 12 exchanges. I've submitted our written testimony for the record, but I'd prefer instead of reading the same material that you have in front of you to speak in my own voice and highlight the issues that we'd like you to focus on.

It's a narrow aspect of the proposed rule that gives the options industry concern and that is that listed options are not included as an asset in the best interest contract exemption and we think that it should be.

The options industry in the United States is a large market and a substantial amount of trading is being done in retirement accounts. In 2014,

3.8 billion option contracts traded in the United States and the TAB group estimates that 29 percent of that is being done by individual investors, and of that amount 15 percent are being done in retirement accounts, IRAs specifically. That means that approximately 165 million option contracts are being traded in IRAs.

Now it's important that we distinguish the listed options market or what we would call the exchange-traded market from the over-the-counter market and other options contracts. These are contracts that are traded on exchange. It's a transparent marketplace, fully regulated, where two-sided markets are continuously displayed throughout the day. We trade options on stock, exchange-traded funds, and indexes. All the underlying assets that we trade are listed on exchanges like the New York Stock Exchange and NASDAQ, and we have listing rules and maintenance rules that require that we trade options on liquid public securities. The same way that stocks are traded, options are traded on listed exchanges.

A good example of how important it is to us to give a investor a positive experience is to ensure that the underlying stock has appropriate liquidity. So, for example, one of our rules says that when a company goes public, the day of its IPO, we cannot list options. In fact, for at least five days the options exchanges do not list options on that underlying stock. It allows the market to find an equilibrium price. It allows the liquidity providers to determine the proper volatility so that they can make an appropriate market in the option. So we give it time for the marketplace to experience the underlying asset before we begin trading options.

It's also important to say that I don't think there's any industry that has more competitive pricing. There are 12 options exchanges. We all trade the same products. And so the market that is being made to the customer is deep in its liquidity, but it's super competitive and the best prices available at all times continuously in the marketplace.

So why is it so important to preserve the right for an investor to trade options from their IRA account? The way the options product is designed is to work one for one with stock. So one contract in an option is associated typically with 100 shares of stock. If you own 100 shares of a company, you can buy one put option or sell one call option. And the two primary strategies that investors use in their IRA accounts are the two most conservative options strategies. They're covered call writing and they're protective puts, and I'll go into that in a little more detail. But it's important to note that both of those strategies provide those investors with the ability to manage the risk of the stocks that they own in their IRA.

When an investor sells a call against a stock position that they already own, they are actually collecting premium. And it provides them a small amount of downside protection if the stock declines, but primarily it brings in money to the investor and enhances the return on their stock. When they buy a protective put against a stock position that they already own, they are managing the risk that the stock will decline and they have an opportunity to protect themselves from a decline in the value without actually selling the security that they own. Importantly, it's the investor that's making the decision what option strategy they should use and not a broker that's giving advice.

Many people say that only wealthy people trade options, but it's simply not the case. As I shared with you, you can trade one options contract on 100 shares of stock. So any size IRA account with stock positions in it has the ability to make use of a very important risk management tool.

Now though options don't require wealth to trade they do require education. There is a unique set of terminology associated with options trading: calls, puts, how much time there is to expiration, strike prices, volatility, and it's important to teach the investor all of these terms so that they can understand the options market. The brokerage firms provide this educational material to their customers to help them understand how to trade options, the different terminology that's used, the different types of strategies that are used, but importantly what they are teaching them is how to use the product. They are not giving them investment advice on the stocks in their portfolio.

Importantly, education does not necessarily mean risk. When people ask me to explain the difference between stocks and options, I sometimes use a car analogy, an automatic car versus a manual car. We all know how to drive an automatic car. We were taught that very early on in drivers ed. But if I wanted to know how to drive a stick shift, a manual, I'd have to learn what's the stick shift, what's the clutch, what's an odometer and how do I use it.

Now using that analogy compared to stocks and options, options give you greater control over your portfolio, just like a manual car gives you greater control, but you need to learn how to use it. The person who teaches you how to use it is not telling you when it's better to use it, but they are giving you all the tools that you need to be able to drive safely.

One other very important safeguard, the industry requires that the brokerage firms qualify these investors before they began to trade options to ensure that they have the knowledge and the experience to be able to trade this product. This is something that has been involved in the industry from the very beginning when we first started the listed markets in 1973. Depending on the knowledge and experience that a customer has, they will be afforded a certain level where they are able to trade, level one being the most conservative options strategies, the two that I talked to you about, the covered call writing and protective puts.

Using the same analogy of a car, I'll tell you that my son just got his drivers license at 17, so for the first couple of months we're telling him that when we're not in the car he's allowed to drive locally, but if he wants to get on the highway, that's going to take a few months and some knowledge and experience before we allow him to go on there. We're not telling him where to drive or how to drive, but we are ensuring that he has the knowledge and experience before he takes on more faster driving in essence.

What are we asking from the Department of Labor? Three things. The first is to include listed options in the definition of assets for the best interest contract exemption. These are fully transparent products on regulated exchanges. They are the sister product of stocks and of bonds that are publicly traded, traded in the very same manner. Importantly, there are no hidden fees or costs associated with trading options.

Secondly, we'd like clarification that if brokerage firms provide this educational material explaining the terminology and the risk reward profile of options that this is not advice for specific investment recommendations and should not cause the broker to become a fiduciary.

And likewise, determining the qualification level of an investor, whether they're level one or higher, is an important aspect, an important mechanism for protecting investors, and that too should not cause the broker to become a fiduciary.

I'd be happy to answer any questions that you have.

MR. HAUSER: Thank you.

Ms. Byrd-Hill?

MS. BYRD-HILL: Twenty-six years ago when I graduated from the University of Michigan with a degree in economics, I embarked upon a life mission to assist the financial stability of my community, both women and people of color. I sit here because I have a multifaceted view of the need to protect vulnerable citizens, that is, the low and middle income, women, and people of color, and when I define people of color, that's African, Arabic, Asian, Hispanic, and Indian descent in their pursuit to save for retirement.

These vulnerable populations often receive conflicted written advice and oftentimes none at all. But I'm going to give you my experience so, as I speak, you know where I'm coming from. I started my career as a plan sponsor of a defined contribution plan for a large privately-held retailer. I then migrated to be a financial advisory firm president of a firm that grew to $353 million of assets under management. In doing so I was able to create a program for UAW Chrysler called Smart Money, the Financial Fitness course. I authored a book called *Breaking Out of Your Financial Funk*. And the last 11 years I spent as the president of a nonprofit, assisting low and middle income residents to move out of poverty. Today out of that nonprofit we have created a company called Weyn LLC where I am the president of a mobile video game developer of economic strategy games.

Before I go into testimony, let's talk about the real problem of why we want to increase the standard. I do believe that the standard needs to be increased. I do believe that it needs to be broad in how we increase it and let me tell you why. First of all, the poverty rates of adults age 65 and above are strikingly terrible. Right now, when we look at the Native American population, poverty among senior citizens is 29.2 percent. When you look at the Hispanic Americans, it's 28 percent. When you look at African-Americans, it's 22 percent, Asian Americans 12.3. But for Caucasian Americans, it's only 7 percent. Then when we start to look at it by gender, men, the poverty rate above age 65 is 7 percent and women is 17 percent.

Now a lot of times you want to say that's because when they started they were in poverty, and that is not true. There are some factors that move that poverty. First of all, when we have investments, in the last 50 years a lot of the ethnic populations have grown in influence. They also have been saving as part of their influence. Sadly, the advice that they're given is not so good. Not only is the advice not so good, a lot of churning of investment accounts happen with those who are not at the top of the charts.

And I'll give you a good example. I had a guy who retired from the UAW as an officer and when he gave me his $500,000, I realized that he's afraid of the market, and even though he wants the market high side potential, I don't look at suitability about the high side potential. I look at what happens when the market drops, what is going to be your response, because that's where a lot of money is lost. So, when I put him in the investment, I considered that. A couple years after he sat in the investment, he's watching everybody talk about 25 percent returns and a stockbroker gets him to move. So even though at that point his return went from half-a-million dollars to

550, he thought that he could get more because of what the stockbroker told him, so he moved.

Well, unfortunately he moved to that stockbroker and that stockbroker moved him from four different mutual fund accounts. Well, when he died, and I have to talk about reality, he had $250,000 in his account over 10 years. Well, he went from a half a million to $250,000, which means he didn't go up, he went down, which is not the place to be. I had to sit in front of that widow, because I had her for other products, to explain the reason why the account went down.

And I don't blame the customer. I blame the subsequent advisor because they didn't do what was in the best interest of the customer. Because the customer is afraid of the market, you know that going into the door, so why would you put him in a product that when he sees the stock market says it's going down, he's going to give you the order to move when everything is tanking? That is the recipe for disaster and that's what happened in 2008 during our recession.

But we don't want to talk about that. So, as we're having the discussion about the fiduciary interest, we have to talk about what happens to the customer on Main Street, not the affluent customer who has two and three and four and five, 20 million. We're talking about the base customer who lands in poverty not because they started in poverty, but they had full intentions to be able to live out their retirement, but because the financial advisor is in a position of trust, the customer relies upon that financial advisor and some of the advice, I would say a lot of the advice is not good.

Number two, while I loved the industry when I was in it for 15 years, a lot of the individuals who come into the industry are not financial experts. They are salespeople. It is what it is. You get compensated not based on educating, you get compensated based on what you sell, so consequently, all of the activity is based on the numbers of what you sell. So we need to toughen those standards because of the population that we have because they're creating poverty where there should not be any poverty.

I felt really horrible to have to explain to a widower that half of her portfolio went because of some unscrupulous advisor who ironically never went to jail even though it's thievery, never was prosecuted, never landed in prison, got a pat on the back and said atta-boy, you did good because you churned the customer multiple times. That is inappropriate and that's what occurs in reality.

Now, with that being said, a lot of that wouldn't occur if there was education. So I've listened to a lot of the testimonies and we went from having a debate over fee-based advisors versus commission-based advisors. To me, it doesn't really matter. As long as you have assets under management, you have conflict. I've been both. And as long as you're managing assets, you do have a responsibility to those assets, to make money from them.

So what I want to present is a third option, not just fee-based or commission-based but what we call a financial wellness advisor. Their job is to be a counselor or coach and to help you move through your retirement because retirement planning is not just about money. It's a whole process. It's about looking at emotional health. It's about looking at your physical health. It's about understanding product knowledge. But the bulk is about understanding financial concepts and tools.

What I have seen is most customers do not understand the concepts. One of the testimonies talked about his grandfather and the investment that they were learning from the grandfather. Reality, a lot of investment is learned at home. But if you have populations who are not privy to be able to learn those investments, they are at a significant disadvantage, which means they have to have financial education to bring them up to speed two, three, four, five generations. I've not seen that. And an advisor sitting and having a discussion over one product is not sufficient education to me.

So what I propose is that we look at a third option of advisor called financial wealth advisors, but we also look at a different way to educate. One of the things that I've noticed is most education is very lecture-based, it is very jargon-based, it is very numbers-oriented, when the bulk of the population are neither. But what we do know is that the population today and yesterday love mobile video games. They play them by the millions. But what we don't know is that women generate 45 percent of the revenues in gaming, which means they obviously love it, and these are women ages 25 to 54, and that people of color dominate the revenues of 64 percent of gaming across the country led by African-Americans.

But yet, when we start to talk about financial education, we never bring those options to the table unless it's children. We never look at adults. There are ways to be able to teach financial concepts that are very easy to people, and video gaming is a mechanism that really should be used for adults, to just look at the concepts and to understand what is an option? You can build that into a game. What is a stock? What is a mutual fund? What is asset allocation? Those are basic financial concepts that people need to be able to understand before you embark on any investment program of any type, and they're not understanding those.

So what I am requesting for the Department of Labor to look at is expanding educational options in the ruling but to also expand the advisor options to include a financial wellness advisor who has no assets under management, whether that advisor is human or whether that advisor is technology, and that can be funded by retirement fees or any other discretionary dollars. I'm also asking for the Department of Labor to consider a pilot of new standards of financial education, to include gaming, and we would love to be able to host that for you.

And lastly what I would like the Department of Labor to do is to share this testimony about what really happens in Main Street and the beauty of potential new options of financial education with your fellow colleagues on the Financial Literacy and Education Commission. Those are the three things that I'd like to see today.

MR. HAUSER: Thank you.

Mr. Trone?

MR. TRONE: Well done. What if I was to tell you that over the last 15 to 20 years fiduciaries have stolen more money from investors and retirement savers than brokers? Now, by the way, I don't know whether that's true or not. But when you consider Bernie Madoff, we're probably not far off the mark.

So I thank you for allowing me to share this day with you today. I've been involved with the fiduciary movement for 28 years, very involved with the movement. I'd love to say that I'm here to support you today, but I'm not. My concern is that what you're proposing is not a fiduciary standard but rather punitive rules that are going to make it easier for dishonest advisors to hide behind the complexity of the rules and harder for honest advisors to provide their services. And as you've heard from other witnesses, those services, the people that are going to be most harmed will be the small pension plans, small retirement savers, small investment advisory firms.

In my first career, I was a Coast Guard helicopter pilot, and military pilots literally live or die by the quality of their checklists and their training programs. So, when I came into the financial services industry in 1987, I was appalled to find that the men and women who were serving as investment fiduciaries had no checklists to help them manage their critical decision-making process, had not received any formal training, many didn't even realize they were serving in a fiduciary capacity. So I have spent this second professional career focusing on developing fiduciary checklists.

These checklists have been used in my speeches, 11 books that I have written and co-authored, and in the training of thousands if not tens of thousands of advisors and brokers, trustees, and investment committee members. What's important to point out about these checklists, and there's one in my written remarks and then I passed one out as a handout to the audience, what's important to remember about these checklists is that all of the practices on the checklist are fully substantiated by existing DOL regulations, regulatory opinion letters and bulletins, and case law.

To be clear, when we talk about principles and practices, we define a principle as a fundamental truth and a practice as a specific application to support the principle. As an example, the best interest standard is a principle, writing an investment policy statement is a practice to satisfy the principle. I think it's safe to say that from most of the witnesses there's agreement on the principle, a best interest principle, but where there's no agreement because there's been no dialogue, at least none that I have heard, is on the practices to define the details of that principle.

For the sake of time, I'm not going to read the 17 practices that I have on the list into the record, but I do want to highlight several of the important practices, such as I mentioned the investment policy statement, controlling and accounting for fees and expenses, having a defined due diligence process for selecting and monitoring investment options, and periodically providing plan sponsors and participants with a performance report to show how they're progressing against their goals and objectives.

When I read the Department's proposal 122 days ago, what I couldn't see in the proposal was reference to these long-established fiduciary best practices. So I started asking other industry experts the following two questions: is the Department proposing additional fiduciary practices to those already required, so in addition to the 17 I have in my outline, or is the Department saying that a fiduciary only has to demonstrate compliance with the new rules? No one seems to know the answers to these two questions, and I would suggest the Department provide answers to those two questions and give the industry an opportunity to contemplate the consequences to those answers for if the answer to the first question is that there will be new practices added to those that are already established, then I think it's going to be almost impossible to provide that bundle of fiduciary practices to portfolios of less than $300,000, and I'm really being conservative. I think the number is north of that.

And if the answer to the second question is that fiduciaries will only have to demonstrate compliance to the new rules, then I'm afraid that the Department will destroy the very essence of a fiduciary standard of care you're trying to promote.

On a related issue, you can't simply wave a wand and make every advisor a fiduciary. In my professional opinion, an advisor needs at least five years of industry experience and additional education and training on fiduciary best practices before that person is capable of judging wisely and objectively, before that person is capable of ethical discernment.

If the Department is going to move forward, I would suggest four steps. Step one, build a checklist. Build a checklist to answer the following question: to be compliant, what practices will a fiduciary have to demonstrate?

Number two, once the checklist is complete, determine which PTEs need to be edited. Trying to address the fiduciary standard at the same time as the PTEs I think is out of sequence. Try to do them together. The analogy I use is building a house. You need to wait until the architect is finished before you let the general contractor begin.

Step three, apply the checklist, implement the checklist and see how long it takes to implement each practice with a participant. Then multiply that time by a reasonable professional billing rate to determine what the minimum account size can be properly served with a fiduciary standard of care.

And then step four, determine how much training is required, how much training, experience, and expertise is required before an advisor can properly implement the checklist.

I believe that if the Department follows these four steps it will determine that the better course of action is not to proceed with the current proposal. Whatever next steps the Department takes, it will need to support the organizations that are providing training and education to fiduciaries and to participants. Unfortunately, there are organizations today that are deliberately interfering with training and others that are making false and misleading statements about their experience, expertise, work experience. Something as simple as the Department identifying an ombudsman for fiduciary training would be a great help.

In closing, a positive statement I can make about your initiative is that you have everybody in the industry standing at attention. If you did nothing more, you have every service provider looking at their business model and determining whether that model measures up to a fiduciary standard or not. Thank you.

MR. HAUSER: Thank you.

Mr. Cunningham?

MR. CUNNINGHAM: All righty. Boy, end of

the road. You all want to stretch? You all want to stand up and stretch or something? You know, it's been a long three days.

I've got a torn muscle in the back of my neck. I'm going to go through this very, very quickly, okay? I'm not stopping. So my head might kind of bounce around a little bit. Firstly, let me say that your work has been spectacular. I don't recall seeing another proposal which was pulled back and then reworked and put out there. I thought that was outstanding. I'm from Washington, D.C.

Now I'm going to spend a couple of minutes -- I'm going to spend one minute going through my background just so you know who I am, because I'm not affiliated with a large financial institution or with a trade association. My background is I was born and raised in Washington, D.C. I have a cousin, Calvin Copeland, who worked in this building for 25 years. My family works in all of the federal agencies. You know, it's a company town and, you know, we grew up here.

Now my educational background is I hold an MBA in finance and a Master's in economics from the University of Chicago. Now that's important because I'm going to reference two of my University of Chicago professors in coming back and analyzing your proposal.

The other thing that I want to point out is that I posted my first website, which was the first investment advisor website, on November 16, 1995, November 16, 1995, at creativeinvest.com.

Now the other thing I want to point out by way of background are some of the things that I've been involved in. So I was registered as an investment advisor with the U.S. SEC. On July 3, 1993, I wrote to the SEC and I warned them about a scam that I had been made aware of, the Nigerian letter scam. I looked at that and I said it was brilliant. I said there are going to be a lot of people that are going to be damaged by this. The SEC's response was to investigate me. I'm Black. You're talking Nigeria. I identified that scam. They did absolutely nothing. There were thousands and thousands of people who were damaged by that scam needlessly, who did not need to be hurt but for the SEC's lack of action.

On December 22, 2005, I testified in front of Elaine Hartmann at the Division of Market Regulation at the SEC and I let her know that my economic models indicated that a crisis was coming and that they needed to do something to tap down the elevated levels of fraud in the marketplace. Most recently, just to show you I'm not making this up, I developed a financial modeling system that incorporates financial and social data to forecast economic activity. Two Mondays ago we forecast that Black unemployment would fall from 9.5 percent to 9.1 percent. Last Friday this Department reported Black unemployment at 9.1 percent. So that's a little bit of background and some of the tools that we use.

Now I believe that my experience, borne of education and experience, can be helpful here. Further, my operating philosophy is this -- it's taken from Martin Luther King -- all investors are caught in an inescapable network of mutuality tied in a single garment of destiny. Whatever affects one investor directly affects all investors indirectly.

That's what you're struggling with with the proposal that you've put forth, which, by the way, I think is good, but all of these exemptions, it's regulation that looks like Swiss cheese, you know. And I would suggest that you pull back and go for what you want to go for, which is a fiduciary standard that is applicable across the board.

Now a couple of other things I want to talk about, why you even need to have a fiduciary standard.

In my testimony, which I'm not sure if you guys have -- do you guys have this? It says "William Michael Cunningham." One of the things I want to point out is page 2 lists all of the issues that have occurred in the financial marketplace since about 2003. That listing rolls on to page 11, all right? These are all cases starting with, you know, some of the fraud that we observed, April 28, 2003, every major U.S. investment bank -- Merrill Lynch, Goldman Sachs, Morgan Stanley, Citigroup -- basically were found to have aided and abetted efforts to defraud investors.

Now I don't know if Goldman Sachs showed up here this week. I don't know if Bear Stearns testified. I don't know if Lehman Brothers testified. I don't know if Bernie Madoff testified. But the reason why you're doing this is because the financial marketplace is broken, all right? I will tell you that as a graduate, free market guy, graduate of the University of Chicago.

Now specifically how it is broken is in this way. You've had a multi-decade set of unethical business practices that have spanned every major financial institution in the country. There are hundreds of cases. Envy, hatred, greed, and other negative behaviors have flourished in capital market institutions. This has propelled ethical standards of behavior downward.

Now why is this important? This is important for this reason only. Listen to me very carefully, all right? Markets cannot survive continuously elevated levels of fraud. The reason they can't survive continuously elevated levels of fraud is because fraud mis-allocates resources from deserving companies to undeserving companies. What you eventually wind up with is the financial crisis where assets have gone to companies and investments that did not deserve the money.

What happens, and we've outlined this in our writings, what happens is the level of trust in the financial marketplace plummets. People don't know who they can trade with. And by the way, I was on the futures and options desk on the institutional side at Merrill Lynch. I was also director of investor relations for a New York Stock Exchange 500 company. And I also managed a money market portfolio for an insurance company. So I just happen to have a very broad set of experiences that encapsulates all of this. That's one of the reasons why I wanted to come down here today.

So, when you have this mis-allocation of resources, eventually markets fail. That's what you saw in 2006, 2007, 2008. The reason why nobody -- and it's probably the first time you've heard this -- the reason why nobody has actually brought this to your attention is because they don't really -- the large financial institutions did very well. They actually did very well. It was the smaller guys that got damaged. Black homeowners, Prince George's County, Wells Fargo targeted them for subprime loans. Nobody at Wells Fargo went to jail, okay? So they did fine. I mean, you know, that's the issue.

In wrapping up, let me point out a couple of other facts. According to the U.S. Department of the Treasury, the financial impact of the financial crisis was $19.2 trillion, a $19.2 trillion loss, all right? And if you have to look at one entity that would be responsible for that loss, it would be the Securities and Exchange Commission.

Now why is the Securities and Exchange Commission responsible for that loss? Because they say their mission is to protect investors. I would submit to you that you can't say that you have competently carried out that mission when you have a $19.2 trillion loss. That loss came about because of the -- I'm going to go back to University of Chicago now, just a warning -- because of the theories of George Stigler, one of my professors, captured. The institution was captured by the industry that they ostensibly regulated.

This is also one of the reasons why you're getting a lot of comments, oh, let the SEC handle it. Why don't you guys coordinate with the SEC? Why would you do that when they're responsible for a $19.2 trillion loss? They're incompetent with respect to this issue. I'm not saying they're bad people. They're just incompetent. They've just been captured by the industry that they are supposed to regulate. You would do well to avoid that same issue.

That is also, by the way, the reason why you're getting letters from U.S. Senators. Where do they get their money from? Is there a capture part of the financial regulatory structure that has embedded itself on Capitol Hill? What do you think? What do you think? Of course there is. So I know these are your bosses. I know you've got to pay attention to them. I'm just saying you should factor in the regulatory capture theory as you look at what's going on.

Finally, and going back to University of

Chicago again, one of my professors, who is a guy named Merton Miller -- you guys ever heard of Merton Miller, Capital Asset Pricing Model -- people have talked about modern portfolio theory up here without recognizing one key point. In the classes I took with Merton Miller, ethical behavior was always assumed as part of the modern portfolio theory, okay? Why is ethical behavior assumed? Because of what I just told you. If ethical behavior is not a part of the marketplace, assets are allocated to companies that don't deserve the assets. And eventually over time, 10 years, it might take 10 years, five years, 10 years, the markets crumble. That's what you're looking at preventing with your fiduciary standard. That's actually where you are.

So I think that pretty much captures most of my testimony. If you have any comments and questions, again -- and thank you for squeezing me in. Thank you, panelists, all right.

MR. HAUSER: All right. Thank you.

MR. CUNNINGHAM: They've got to squeeze me in on this thing at the last minute.

MR. HAUSER: All right. Thank you.

MR. CUNNINGHAM: But I appreciate it.

MR. HAUSER: Thank you very much.

Judy?

MS. MARES: So, Mr. Katz, I wonder if I could ask you a question or two.

MR. KATZ: Yes.

MS. MARES: You were talking about the listed options and you referred to different levels

of -- I'm trying to think of -- you talk about the covered option strategies of puts and calls were level one.

MR. KATZ: Right.

MS. MARES: Could you just give us a sense of what some of the other levels are? I know all option strategies aren't created equal. A little lesson on that might be helpful.

MR. KATZ: Right. There are many different option strategies and option strategies that have clearly defined risk reward where there is limits to loss tend to be the more conservative and the ones that are used for risk management. The ones at the higher end of the scale are the ones that have the potential for large losses where they're unsecured, where you don't own the shares of stock. And that's why the options product is so well aligned with the investors in these IRAs, because they're aligned to the shares of stock that they own and that controls the risk and why they're at level one.

MS. MARES: So, as you talk about your recommendation that we include the listed options, are you reserving that to level one strategies or unlimited strategies? I'm just not clear.

MR. KATZ: We're reserving it to the strategies that are allowed in IRA accounts.

MS. MARES: Okay.

MR. KATZ: And that's done on a firm-by-firm basis. The vast majority of trading that's done in IRAs is the covered call writing. The next second level is this protective puts, but it's far below that and those are the two largest. And so I don't believe that we're recommending that you limit it to level one, but as you move higher up in the levels, those investors have greater experience with those types of strategies and at all times the IRA levels secure the investment that's being made. So the opportunity for entering into an option strategy that could wipe out the entire IRA are absolutely not allowed in these accounts.

MS. MARES: That's helpful. Thank you. You talked about the desire to ensure that the broker's education of the customer was strictly just education. So, in your experience, the IRA investors who use the puts and call strategies do this through their own self-directed accounts?

MR. KATZ: That's correct.

MS. MARES: And how do you -- what are the tests that are necessary for them to get qualified? You know, we've got a party that's educating and then they're going off and saying, okay, now I want to do this. How does that education ensure that the investor who really should be doing very conservative strategies doesn't end up with very risky strategies?

MR. KATZ: So really there are two independent efforts: one is education; the other is the qualification of your level to trade.

MS. MARES: Okay.

MR. KATZ: You can take classes in the trading of options and you can go to multiple classes, you can go online, you can use software and simulate trading. But up until you go and open up an account and say that you want to trade options you don't go through that qualification process. So they're really independent of each other.

MS. MARES: Okay.

MR. KATZ: And just because you're educated doesn't mean you have knowledge and doesn't mean you have experience. And so they work well together, but they're independent.

MS. MARES: Okay.

MS. LLOYD: Could I follow up on that, well, on some of Judy's questions to Mr. Katz? So first question, do you have to open a margin account when you trade in listed options or is that not necessary?

MR. KATZ: I don't know the answer to that. That's a question that the firms would have to answer. There are certain strategies that would require that and other strategies that don't where you have to have the full amount of the investments in the account to be able to make the trade.

MS. LLOYD: Okay. And then I guess I was hearing sort of competing things in terms of self-direction and sort of you wanting clarification that some of the things that brokers were going to do were not going to be fiduciary, but yet you do want this included in the exemptions. So that seems to contemplate that brokers will be providing advice on these, or is it sort of just in case they cross the line?

MR. KATZ: Well, let me use stock as an example that we're all very comfortable with and where they are on the list as an asset that has the exemption, but there's a very clearly defined process where you would test whether a broker is a fiduciary or not. If they are giving advice on what stocks to buy, just because they're part of the asset list for the exemption doesn't mean that they're not a fiduciary in that situation.

And we're saying the same thing with options. They are a highly liquid exchange traded product like stock and bonds. The education process and the qualification process without recommendation of what trades to do should be clarified to not make the broker a fiduciary. However, if the broker is giving advice --

MS. LLOYD: Okay.

MR. KATZ: -- then they clearly are a fiduciary.

MS. LLOYD: Okay. Thank you.

MR. CAMPAGNA: Do you have any more that you could tell us in a comment or otherwise about this education process and how it might work? I mean, is it kind of one-on-one with the broker? Is it some kind of training class with the individual participant?

MR. KATZ: I think the list is varied. There's material that can be handed out. That material is vetted by the regulators, in this case

FINRA. And there is a certain oversight by FINRA in the exchanges of the qualification process, so that it can be online education. It can be taking classes. But typically, you know, there's no one formula for how you would educate a customer.

What we're finding today is that investors that are coming out of universities today have far greater knowledge of the options product than they did 25 years ago. Today in a business class or any class you are educating the students in the variety of products that are out there. And that's why I keep going back to the concept of stock and bonds, because what the investors recognize today is there are exchanges, not just the stock exchanges but the options exchanges where they have a transparent, highly liquid, constant bids and offers, and a secondary market where they can buy and they can sell. It's not a pricing issue like some of these more complex products. And as a result, it's important that they understand the different asset classes that are out there and available that they can trade in a transparent marketplace.

MR. CAMPAGNA: And just to reiterate, you're only talking about options that have this conservative strategy associated with it?

MR. KATZ: And listed options that are traded on exchanges.

MR. CAMPAGNA: And listed options, right. Thank you.

MR. COSBY: Mr. Katz, I was curious about the compensation model for the brokers that sell these option products. Is it similar -- you mentioned -- you know, you just were mentioning stocks. Is it similar to brokers that sell stocks and mutual funds and other more typical assets?

MR. KATZ: It's the same as the model for stocks.

MR. COSBY: Okay. And, Ms. Byrd-Hill, I had a question for you.

MS. BYRD-HILL: Sure.

MR. COSBY: With regard to your financial wellness advisor concept --

MS. BYRD-HILL: Uh-huh.

MR. COSBY: -- the rule has an education carve-out now where certain type of education activities are considered to be fiduciary investment advice. So I was wondering if that's sufficient for what you're trying to do with your product or were you looking for something else with respect to that?

MS. BYRD-HILL: I don't think that it's

sufficient. Part of the reason why I don't think it's sufficient, you can't make up generations of knowledge that are passed across the kitchen table with one session with an advisor. And so, when I looked at the financial session in your rule, it's very narrow. I mean, you divide whether you're giving advice on a product as education or whether it's advice, and I just don't think that that's sufficient.

The way that the financial world works, there are thousands and thousands and thousands of products. You can't do that in a session, and that's where the rub is. You just can't do it in one or two sessions. So there has to be something that as an individual is going into a retirement plan, that there is a more substantive education that is occurring. And I just don't see it happening. I've been at all facets and I'm not seeing it. So I think that if you're going to say that you're going to have a higher fiduciary standard someone has to have the responsibility to educate the participant.

Now let's talk reality. When these plans, particularly 401(k)s and 403(b)s and 457s, came out, the discussion was that the actual plans themselves were going to be able to be responsible for the investments. But when they realized that the companies would have a much higher fiduciary standard, they decided to make them self-directed. Well, what happened when they made them self-directed? No one put in a really substantive education process in that self-direction, and that's the problem.

And so even though you have discussed it on the periphery, at the end of the day people won't get cheated if they have knowledge. One of the reasons they're getting cheated and they're getting involved in scams is because they just don't know and there's no real place for them to go. And even though we want to say, well, we're going to put it in the literature, I've looked at that literature. It's compliance written because the compliance department decides how it's written. It's written at a 12th grade level when the bulk of the people reading it are at a 6th grade level. It's written for a college person when we already know in this country only 25 percent of the individuals in totality have a Bachelor's degree. So that says 75 percent of the people don't. And it's just not written for the common person.

Now let's talk reality. All week I've heard about, you know, that if we increase fiduciary standards we're going to squeeze out the small- and middle-size investor. The real truth of the matter, the financial industry really doesn't cater to those people. They cater to them to churn to make extra money to beef up their commissions because the whole industry is catered to the wealthy. Let's just be very honest. They've survived hundreds and fifties of years because that's who they cater to.

So the issue is that in order to take a person who's low and middle income and give them three, four, five generations that the wealthy have of knowledge, there has to be a broader spectrum of knowledge. And even though we have this Financial Literacy Education Commission which includes all of these agencies, I am not seeing that broader education occurring. But then we want to say, well, we're going to leave it to the K-12 schools. That's not happening there either. Then we say we're going to leave it to the colleges. And while it happens in business school, it doesn't happen anyplace else.

So, in order to protect the citizenry of the United States, someone has to step up to the plate and say, guess what, we have got to broaden the knowledge for all Americans, not just for the wealthy, for all of us. And that requires a substantial discussion so that when they're at the kitchen table and you're learning finances from your parents, not just the child knows, the parent knows, the grandparent knows, and et cetera, and that's not happening.

MR. HAUSER: Thank you very much. And that concludes the panel. Okay? Thank you all very much for your time.

I'd just like to make, you know, a very short at the end of four days concluding remark, which is primarily just to thank everybody who participated in the hearings, all the people who have submitted comments to us. It really has been enormously helpful, it's been enormously informative to us, and we are, you know, taking all of your comments into account, and I think you'll see that it makes a difference.

And to that end, I just remind everybody that in about two weeks we hope we'll have the transcript posted and we would encourage you to reflect on all of the back and forth of this hearing, as well as what, you know, people submitted in their other written comments and give us the benefit of your thoughts if you're so inclined about what people had to say and about what's in the other comment letters as well and really with respect to all aspects of the project.

I mean, we have, as Assistant Secretary

Borzi said at the outset of the hearing, what we think is largely a common goal, which is to make sure that when people consult investment professionals about their retirement investments that they can count on receiving advice that's in the best interest and they can count on that advisor's interests being aligned with their own.

But obviously, as I think four days of hearings have made completely clear, there are, you know, many views on how best to achieve that goal and many views on how best to even articulate the goal. So I would just encourage everybody to fully participate and I thank you all. And in light of the comments maybe of the last group, I would also thank the folks at the SEC, who actually were enormously helpful as we developed this project in terms of technical assistance, and I certainly plan to continue to get as much help as we can not just from you all but from our co-regulators. So thank you very much. That's it.

(Whereupon, at 2:17 p.m., the hearing in the above-entitled matter was concluded.)

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REPORTER'S CERTIFICATE

CASE TITLE: Conflict of Interest Proposed Rule Meeting

HEARING DATE: August 13, 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 13, 2015

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