Department of Labor Hearing

Proposed Fiduciary Rules

Statement of David W. Blass

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Good morning, and thank you for the opportunity to testify today. My name is David Blass, and I am general counsel of the Investment Company Institute.

The regulated funds that ICI represents are especially attuned to the needs of retirement savers. Mutual funds alone account for about half of retirement assets in defined contribution plans and individual retirement accounts. Fund advisers recognize the trust and confidence that retirement savers have placed in them, and they labor every day to live up to savers' expectations.

In that vein, we agree with the Department on the underlying principle behind the proposed fiduciary standard: financial advisers should act in the best interests of their clients.

But as the long history of the Department's efforts makes clear, crafting a fiduciary rulemaking is a significant undertaking and requires care and a focus on clarity and simplicity wherever possible. It is all too easy make that kind of rulemaking overly complicated and confusing. Quite regrettably, we believe the Department has done just that, ending up with a proposal that does not remotely resemble the principles-based approach Secretary Perez has described.

In fact, if the Department adopts the rules as proposed, we have grave concerns that retirement savers will be harmed, not helped. As drafted, the proposal will limit retirement savers' choice of advice provider and will restrict savers' access to information they need for retirement planning. It also will increase costs, particularly for those retirement savers who can least afford it.

This is because the net effect of the proposed rules, if adopted as currently drafted, would result in retirement savers having access to less information and guidance that they currently rely on and need to make informed investment decisions. Some savers will pay more for advice because they are effectively forced to use fee-based advisers that come with higher costs for those savers. And, worst of all, some savers, primarily those with the smallest account balances, will lose access to any advice.

Fortunately, there remains the opportunity to correct these problems, and I would like to describe five of our primary recommendations for doing so.

First, the Department must fundamentally revisit the deeply flawed justification for the rule proposal described in its Regulatory Impact Analysis. This topic will be addressed at length tomorrow, so I will only mention here that the RIA fails to consider publicly available data that contradict the RIA's conclusions and does not analyze the significant harm to retirement savers that is sure to result if the Department adopts the rules as currently drafted.

The results of an impact analysis must inform an agency's policy choices. We believe strongly that if the Department reassesses its impact analysis in light of comments, it will make policy choices that meet its goals while making its rule simpler, more workable, and better for investors. ICI stands ready to assist the Department in this undertaking.

Second, the Department needs to be more targeted in crafting a fiduciary definition. The proposed definition would attach fiduciary status to many ordinary day-to-day interactions that do not entail a genuine fiduciary relationship—for example, when a retirement saver simply wants to talk with someone, either by phone or in person, about the availability of services and potential investments for his or her account.

Fiduciary status entails one of the highest obligations known to law—and carries with it a host of prohibitions under ERISA. Because of the restrictive nature of these prohibitions, rules governing what activities give rise to a fiduciary relationship must be quite clear, not overreach, and provide a meaningful ability to market or sell one's services and products to all savers.

The practical consequence of this aspect of the proposal would be quite damaging for retirement savers. Unless the Department clarifies that these basic day-to-day interactions are not fiduciary activities, many providers will have no choice but to stop offering them. Put more simply, retirement savers would lose the ability to talk to someone about services and potential investments for their retirement accounts, and they would lose access to information they rely upon today that is provided through websites, newsletters and other sources. They would lose the ability even to see examples of investment options that would fit a model portfolio.

This risk is both probable and foreseeable. Just last week, the UK government launched a review of the advice gap for small accounts. We should learn the lesson from the UK and take steps to promote advice being provided to savers with small accounts, not impede the provision of that advice, as the proposed rules would do.

At a minimum, the Department must craft the definition more carefully to capture only individualized recommendations that are intended for a retirement saver to rely on to take a specific action. We provided alternative text in our letter that would accomplish this goal. The Department also should provide a meaningful seller's exception that covers all savers and that would apply to true marketing and sales activities.

Third, the Department must greatly simplify the rules' exemptions. These exemptions are essential to making the rulemaking workable. They, in turn, must offer clarity and practical conditions.

The most sweeping exemption is the "Best Interest Contract" exemption. As drafted, that exemption is quite useless because it imposes a multitude of ambiguous and impractical conditions on brokers or others who wish to rely on it. The result will be that savers who today rely on brokers and other commission-based advisors for investment services will no longer be able to do so. They will be forced either to switch to fee-based advisers, increasing their investment expenses, or to go without advice—the most costly course of all.

A better approach is to heed Secretary Perez's call to give sufficient flexibility and discretion to allow fiduciaries to determine how best to satisfy their duties in light of the unique attributes of their businesses and, I would add, the needs of investors.

Here, simplicity and flexibility is needed. The exemption will work only if the Department streamlines its excessive and impractical conditions.

The Best Interest Contract exemption needs many changes, but the Department should start by eliminating the proposed contract and the contractual warranties and representations. They are not needed to protect investors and only serve to expose firms to significant new litigation risk.

The Department also needs to simplify and streamline the required policies and procedures requirement for “material conflicts of interest.” As drafted, those conditions serve only as compliance traps for advice providers.

The Best Interest Contract exemption also would impose a new set of disclosure requirements that are redundant, granular, and costly. Instead, the Department should implement a more useful disclosure model that it already has in hand—the disclosure regime under ERISA sections 404(a) and 408(b)(2). Those disclosure requirements were issued only after significant debate as to how best to inform retirement investors. They are well understood by plans and providers. And, importantly, they would not overwhelm retirement savers with useless information that is likely to confuse, not inform them.

Fourth, the Department should avoid retroactive application of the rules, if adopted. Retroactive application would unnecessarily harm retirement savers by effectively prohibiting ongoing advice on assets acquired prior to the rules’ implementation dates.

Fifth, the Department should abandon the notion of a potential “high-quality low-cost” exemption. We have grave concerns about this exemption’s feasibility and wisdom.

The proposal’s befuddling series of questions on that topic raises a host of conceptual issues that preclude meaningful comment. The Department does not explain, for example, how such an exemption would work or indicate what investments would or would not qualify. The Department clearly has not provided sufficient information about this aspect of its proposal to allow the public to comment in any meaningful way.

Thank you again for the opportunity to present these views. The Institute strongly urges the Department to look at the entire proposal in light of our comments and the many other comments it has received and to draft appropriate revisions using a transparent process. This would allow it to avoid negative, unintended consequences for retirement savers. After all, it is in the best interest of Americans saving for retirement that the final rule be clear and practical.

I would be happy to answer any questions you might have.