



WHETHER OR NOT TO PUT RETIREES' INTERESTS FIRST? THIS DOES NOT NEED TO BE COMPLICATED, OR DOES IT?

The Washington regulatory battle between the Department of Labor (“DOL”) and Wall Street over whether brokers working with retirees should be governed by a fiduciary duty standard was on full display yesterday in testimony before the Senate Health, Education, Labor & Pensions Subcommittee on Employment and Workplace Safety. The pending DOL rules are either needed to protect the retirement savings of millions of investors, or would be counterproductive and unworkable.

At the center of the controversy is a proposal by the DOL that would offer new protections for retirement investors working with brokers and other financial professionals (who are not registered investment advisors), but provide advice regarding retirement accounts, including 401(k) plans and defined-benefit plans. The proposal would require that brokers providing retirement advice act in the best interest of their clients. Currently, only registered investment advisors are governed by the fiduciary duty standard. Ordinary brokers are governed only by the less strict “suitability” standard. Retirement plan trustees are very familiar with the strict fiduciary standards governing their advisers, who are registered with the Securities and Exchange Commission.

Based on extensive review of independent research, the White House Council of Economic Advisers found that conflicts of interest by brokers costs retirees about 1%, amounting to \$17 billion per year in lost retirement savings. The DOL's proposed conflict of interest rules are intended to close regulatory loopholes, update the law, and clarify the advisory landscape for investors and brokers.

Secretary of Labor Thomas Perez's testimony regarding DOL's reasonable, flexible rules:

- We believe that we have proposed a reasonable, middle-ground approach that is responsive to our extensive outreach and feedback. It is grounded in a basic principle – that investment advisers should act in their clients' best interest, not their own. The proposal remains open for comment in the Federal Register and I want to assure all stakeholders, including Congress, that the Department is very open to input to further refine, clarify, and improve this rule.
- Retirement security is a fundamental pillar of the middle class. We must ensure that Americans who work hard and save responsibly for retirement are getting a fair share of the returns on those savings. This Subcommittee knows too well that there is a retirement crisis in America and that not enough Americans are saving for retirement. I'm deeply concerned that even if you've done the right thing, worked hard, and saved what you could, you could end up in a situation where you do not have what you need for retirement simply because your adviser isn't required to put your interests first. The majority of advisers already do the right thing and serve their clients' interests first, but most Americans do not have room for error and cannot afford to invest in products with unnecessarily high fees or low returns that benefit their advisers but do not meet their own needs.

- Losses due to conflicts of interest, on average, reduce returns for affected savers by about 1 percentage point per year. Over 35 years of saving, this could reduce savings by more than a quarter. And in many cases, the affected consumers don't even know it is happening. The lack of rules of the road is confusing, it creates an un-level playing field, and it hurts working people who just want to be able to save enough to retire comfortably.

Quick summary of proposed conflict of interest rules:

- The proposal will close the loopholes in the 1975 DOL rule that today make it possible for advisers to exclude from protection the kind of advice relationships that are common now for 401(k) and IRA holders. Under the proposal's new definition, a fiduciary is a person providing investment advice for a fee or other compensation with respect to a plan or IRA if either the person doing so acknowledges he or she is acting as a fiduciary within the meaning of ERISA or the Internal Revenue Code OR the advice is provided pursuant to an agreement or understanding, written or verbal, that the advice is individualized to, or specifically directed to, the advice recipient for consideration in making investment or management decisions with respect to investments of plans or IRAs.

- To serve our second principle *to allow maximum flexibility*, the proposal that we published in April does not include detailed rules as to what advisers can and cannot do to serve their clients. Instead, the proposal has one fundamental tenet that should be unassailable -- retirement advisers should put the best interests of their clients above their own financial interests. This proposal is intended to *provide guard rails, but not to be a straitjacket*, because we know *there is not a one-size-fits-all solution to putting clients' interests first*.

- Our proposal's second principle is best illustrated by the proposal's carve outs and exemptions, which allow for flexibility and workability. The proposed exemptions from ERISA's

prohibited transaction rules would broadly permit firms to continue common fee and compensation practices, as long as they are willing to adhere to basic standards aimed at ensuring that their advice is in the best interest of their customers. Rather than create a highly prescriptive set of transaction-specific exemptions, the Department instead is proposing a set of exemptions that accommodate a wide range of current business practices, while minimizing the harmful impact of conflicts of interest on the quality of advice.

Introduction by Chairman Johnny Isakson (R-GA) and Ranking Member Al Franken (D-MN)

The title of the hearing is instructive, reflecting Wall Street opposition to the administration's proposed rules: "Restricting Advice and Education: DOL's Unworkable Investment Proposal for American Families and Retirees." According to Chairman Isakson, the rules are a "solution in search of a problem" and unnecessarily devote hundreds of pages to redefining a single word. Chairman Isakson is concerned that the rules would be unworkable, counterproductive, and would wind up limiting access by the middle class to retirement advice. Ranking Member Franken jokingly indicated that he was taken back by the title of the hearing and would have renamed it: DOL's Fiduciary Proposal – What a Great Rule.

Panel Testimony and Comments

The Chamber of Commerce and other critical industry groups call the DOL's proposal "unworkable" and a "jurisdictional land-grab." One element of the proposed rules that is particularly contentious is the lead role of the Labor Department. Critics assert that the proposed rules should be under the jurisdiction of the SEC, which traditionally has been the lead Wall Street regulator. Other critics believe that the proposed rules would raise the costs of obtaining financial advice for middle class Americans who need it the most. By contrast, AARP supports

the proposed rules. FINRA supports a best interest fiduciary standard, but recommends substantial improvements to the proposal.

Senator Elizabeth Warren (D-MA) took issue with the suggestion that the current “suitability” standard was adequate to protect retirees. In particular, she questioned one of the panelists about allegations by Florida firefighters, teachers and other public employees that Primerica brokers encouraged them to cash out their defined benefit pension in favor of riskier mutual funds that would generate commissions for Primerica. It has been reported that last year Primerica set aside \$15 million to settle allegations involving 238 such cases. While the President of Primerica was quick to point out that his company did nothing illegal, Senator Warren emphasized that this was her point.

Do you agree? Should all retirement assets be governed by a fiduciary duty standard? Are public sector employees who are on the verge of retiring better served by cashing out their monthly defined benefit? Are such retirees best served by a fiduciary duty standard when retirement assets are rolled over to an IRA? To date, the DOL has received over 500 comments. The comment period is being extended. Stay tuned for future updates, as the proposed conflict of interest rules travel through the rulemaking process.

Links:

Hearing streaming video: <http://www.help.senate.gov/hearings/restricting-advice-and-education-dols-unworkable-investment-proposal-for-american-families-and-retirees>

Secretary Perez’ testimony: <http://www.help.senate.gov/imo/media/doc/Perez8.pdf>

DOL’s proposed rules: <http://webapps.dol.gov/FederalRegister/PdfDisplay.aspx?DocId=28201>

Comments: <http://www.dol.gov/ebsa/regs/cmt-1210-AB32-2.html>