H.R. 2269, THE RETIREMENT SECURITY ADVICE ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON EMPLOYER-EMPLOYEE RELATIONS

OF THE

COMMITTEE ON EDUCATION AND THE WORKFORCE

HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

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H.R. 2269

THE RETIREMENT SECURITY ADVICE ACT

July 17, 2001

U. S. House of Representatives

Subcommittee on Employer-Employee Relations

Committee on Education and the Workforce

Washington, D.C.

The Subcommittee met, pursuant to call, at 10:30 a.m., in Room 2175, Rayburn House Office Building, Hon. Sam Johnson, Chairman of the Subcommittee, presiding.

Present: Representatives Johnson, Fletcher, Boehner, Ballenger, McKeon, Andrews, Rivers, McCarthy, Tierney, and Ford.

Staff Present: Ben Peltier, Professional Staff Member; Ken Talbert, Professional Staff Member; Dave Thomas, Legislative Assistant; George Canty, Counselor to the Chairman; Peter Gunas, Director of Workforce Policy; Jo-Marie St. Martin, General Counsel; Heather Valentine, Press Secretary; Patrick Lyden, Professional Staff Member; Michael Reynard, Deputy Press Secretary; Deborah L. Samantar, Committee Clerk/Intern Coordinator; Michele Varnhagen, Minority Labor Counsel/Coordinator; Camille Donald, Minority Legislative Associate/Labor; Brian Compagnone, Minority Staff Assistant/Labor.

Chairman Johnson. The Committee will come to order. Well, good morning. We do have a quorum, and we are meeting today to hear testimony on the Retirement Security Advice Act, and how it will help workers manage their retirement income assets. I am going to limit the opening statements to the Chairmen and Ranking Minority Member. Therefore, if other Members have statements, they may be included in the record.

With that, I ask unanimous consent for the hearing record to remain open 14 days to allow Members' statements and other extraneous material referenced during the hearing to be submitted in an official hearing report. Hearing no objection, so ordered.

OPENING STATEMENT OF CHAIRMAN SAM JOHNSON, SUBCOMMITTEE ON EMPLOYER EMPLOYEE RELATIONS, COMMITTEE ON EDUCATION AND THE WORKFORCE

Good morning, and let me extend a warm welcome to all of you and to Congressman Rob Andrews, our Ranking Member, to my other colleagues and our panel of witnesses. Thank you very much for being here.

Our hearing today is going to focus on the need for rank and file workers to have access to high-quality professional, investment advice. Most employees today have unprecedented control over their retirement savings but little guidance in how to make the nest egg grow. The Information Age has compounded this problem. With the emergence of the Internet and other innovations that deliver instant news and stock updates, employees today are literally bombarded with tips and advice about the market. And if you think you know more than the market, you are probably losing money. Occasionally, this information can be helpful. Sometimes it is just contradictory, and often just plain lousy.

Unfortunately, an outdated Federal law, a portion of the 1974 Employee Retirement and Income Security Act, or ERISA, denies workers access to investment advice that could help them make the most of the freedom they have to control their retirement savings. As a result, wealthy individuals enjoy the luxury of being able to afford their own professional investment advice. Consequently, the wealthy have reaped the benefits of long-term gain in their stock portfolios.

Yet, without professional guidance, how are everyday hardworking Americans supposed to reap the same benefits? Simply put, they can't. Moreover, few workers have the experience to make sound investment decisions that will protect them from the upturns and downturns of the market, and many rank and file workers don't have enough time, confidence, or advice to make a sound investment decision on their own. The last month’s roller coaster market serves as a perfect example.

Last year, popular 401(k) retirement savings plans lost money for the first time in their 20-year history, despite thousands of dollars of new contributions. And as the NASDAQ slipped, many workers suffered significant losses. In some cases, it jeopardizes their retirement. It stands to reason that many of these losses could have been prevented if employers were permitted to provide workers access to investment advice to complement their employer-employment retirement plans.

We have authored bipartisan legislation, H.R. 2269, filed by our Chairman, Mr. Boehner, The Retirement Security Advice Act that would remove Federal obstacles to employer-provided investment advice. This measure includes rigorous safeguards to shield employees against abuse, and maintains tough penalties for any advisor who acts solely in the interest of the worker. This measure will help give people payment as they prepare for the time they no longer have to go to work.

I look forward to hearing about these and similar issues of importance from the Assistant Secretary and our other witnesses who are with us this morning. As employees gain greater and greater control over their retirement savings, the importance of creating an informed investment-minded workforce has never been more apparent. High-quality professional investment advice must be readily available. Let us close these advice gaps to ensure that everyone, not just a few, can pursue the American dream.

I will now yield to the distinguished Ranking Member of the Subcommittee, Mr. Andrews, for whatever opening statement he wishes to make, sir.

WRITTEN OPENING STATEMENT OF CHAIRMAN SAM JOHNSON, SUBCOMMITEE ON EMPLOYER EMPLOYEE RELATIONS, COMMITTEE ON EDUCATION AND THE WORKFORCE – SEE APPENDIX A

STATEMENT OF RANKING MEMBER ROBERT ANDREWS, SUBCOMMITTEE ON EMPLOYER EMPLOYEE RELATIONS, COMMITTEE ON EDUCATION AND THE WORKFORCE

Good morning, Mr. Chairman. Thank you. And thank you, ladies and gentlemen.

Government is at its best when it solves problems, and I do think there is before us today a significant problem. The problem is the proverbial cloud within a silver lining. The silver lining is that the growth of our economy over the last decade or so, coupled with the expanding breadth of equity ownership in our economy, has created a new situation. The situation is that there are scores of Americans who, through self-directed pension plans, now must make decisions about where to invest their money. We can quarrel whether that is the best format for pension holdings, but we can't quarrel with the fact that it is the reality for more and more people. There are many people who are making crucial decisions every day about where and how to invest their money, and the consequence of these decisions will be very significant for the rest of their lives.

We have a pension system in this country that is essentially based on the assumption that people will live to be about 75 years old. Happily, advances in medical technology and nutrition and other forms of health care mean that life expectancy is growing for many people at a rapid clip. This is a very good thing. But one of the issues raised by this is how do we help people maintain an income that will sustain them through this longer life? Pensions are more important today than they ever have been before, and the size of one's pension and the dependability of one's pension more and

more depends upon one's own decisions in self-directed accounts as opposed to decisions made by trustees in more orthodox traditional defined benefit plans.

The people who most need investment advice are the people least likely to receive it, people who are at the lower ends of the income scale, who are least likely to expend money out of their pocket for the advice of an attorney or an accountant or a professional planner. These are people who most need good guidance on what to do with these very important decisions. So the problem is how to create such an opportunity for advice. The proposal by the Chairman of the Committee, Mr. Boehner, is one idea about how to accomplish that. I look forward to hearing each witness' interpretation of what the problem is and how it might be solved.

One of the concerns that I will be focusing on throughout the hearing and in the discussions and negotiations that will no doubt follow is how we can provide meaningful, timely disclosure to pensioners and employees about facts that are material to their decision. There is a big difference between receiving an employee manual on your first day of work that tells you, on page 63, that choosing one fund over another has an impact on who gets paid or how much you receive. There is a big difference between that and knowing, at the time you make a decision in a way that is meaningful to you, what the decision means.

Solving this problem is going to require a balance between what I believe is an indisputable reality that many Americans are not getting the advice they need to invest their pensions with the need to continue to protect people by making sure they have relevant, full, and timely knowledge of all facts that bear upon the decision that they are about to make.

This need not be a partisan or ideological discussion. It should be a problem-solving discussion, and I look forward to hearing from the full array of witnesses this morning, working with Members on both sides of the aisle of this Subcommittee and the Full Committee, to try to solve this problem.

I commend Chairman Johnson for bringing together a very astute panel, and look forward to hearing to the witnesses. Thank you.

Chairman Johnson. Thank you, Mr. Andrews.

Mr. Boehner, the Chairman of the Committee, is here. H.R. 2269 is his bill. So I yield to Mr. Boehner, if he wishes to make some comments.

STATEMENT OF CHAIRMAN JOHN BOEHNER, COMMITTEE ON EDUCATION AND THE WORKFORCE

Well, Mr. Chairman, thank you, ladies and gentlemen. Let me give all of you a warm welcome to this morning's hearing, and let me thank my good friend and the Ranking Member of the Subcommittee, Mr. Andrews, who I have worked with over the

last year and a half to develop this legislation and to keep this process moving. I also want to thank Mr. Johnson for his leadership on the Subcommittee and the hearing that we are about to have.

We are living in interesting times. When ERISA was signed into law some 27 years ago, fewer than one in five American families invested in the stock market, and today that number is closer to one in two American families who are now investing in the stock market. No one would have imagined that the Dow Jones industrial average would have increased some 1800 percent since 1974, just as no one could imagine that over the past year, employees in 401(k) stock plans by and large would lose money for the first time. So I think this is a bill that is meant for interesting times. As market volatility over the last several months has shown, investment decisions need to be based on solid and experienced judgment. As I have said before, 401(k) plans did in fact lose money last year, the first time in the 20-year history of 401(k) plans.

Nevertheless, part of ERISA creates powerful and unnecessary obstacles for high-quality investment advice provided through an employer. Last year this Subcommittee held extensive bipartisan hearings on ERISA's investment rules. The need that many workers have for quality investment advice came out of those original hearings. You know, if you go back to 1974, retirement savings to most people meant having a bank account. Now it means 401(k) plans, IRAs, annuities, mutual funds and a whole range of investment products that go well beyond what was available to the average American in 1974.

The authors of ERISA never contemplated that 50 percent of American families would own stocks, and could never have anticipated that we would have this huge movement from defined benefit plans to defined contribution plans. Wealthy Americans can weather the storm because they can afford to go out and get high-quality investment advice, but few working families can afford such a luxury on their own. I think employees and employers agree that there is an obvious solution to the dilemma: Allow employers to provide their workers with access to high-quality, conflict-free investment advice. I think the bill that we have before us does just that.

Now, are there risks associated with moving this piece of legislation? Yes, there are. We believe under the bill that there are great safeguards in place to protect employees from those who may benefit at their expense, whether it is the timely disclosure of conflicts, fees, or holding these advisors to the highest fiduciary duty. The safeguards are there; but yet is there risk? There is, but I would argue that the risk in doing nothing is to the far greater detriment of American workers in their retirement years.

Sometimes we protect American employees, using this case as a good example, to the extent that the only place they can get good investment advice is from “Bob” at the coffee shop. What we have tried to do here is balance the risks with the potential rewards for the benefit of American workers. I believe that the bill we have before us does just that. I am certainly interested in what our witnesses have to bring to us today. No bill is ever perfect, and so for those who have constructive advice, I am here to listen.

Thank you.

WRITTEN STATEMENT OF CHAIRMAN JOHN BOEHNER, COMMITTEE ON EDUCATION AND THE WORKFORCE – SEE APPENDIX B

Chairman Johnson. Thank you, Mr. Boehner.

It is now my honor to introduce as our first witness, Ann Combs, the Assistant Secretary of Labor for Pension and Welfare Benefits, representing the Department of Labor. We are indeed lucky to have someone with her record and reputation in such an important position of responsibility. The Assistant Secretary has a proven record of effectiveness on employee benefits issues in and out of government. She also served as Deputy Assistant Secretary of the Department for Pension and Welfare Benefits during the Reagan and Bush administrations, and has remained on top of the numerous changes in the employee benefits world in her roles in the private sector.

The high degree of regard for her integrity and capability was reflected earlier this year when she was confirmed unanimously 98-to-nothing in the Senate. This Committee congratulates you and welcomes you here today.

Let me remind you, Ms. Combs, that under our Committee rules, you should limit your oral statement to 5 minutes, and your entire written statement will appear in the record. With that, would you please begin your testimony.

STATEMENT OF THE HONORABLE ANN L. COMBS, ASSISTANT SECRETARY FOR PENSION AND WELFARE BENEFITS, U. S. DEPARTMENT OF LABOR, WASHINGTON, D.C.

Chairman Johnson and distinguished Members of the Subcommittee, I am Ann Combs, Assistant Secretary for Pension and Welfare Benefits at the Department of Labor. PWBA is the Agency responsible for administering and enforcing the Employee Retirement Income Security Act, ERISA, the primary Federal statute governing employment-based pensions and group health and welfare benefit plans. I appreciate the opportunity to testify before you today on H.R. 2269, The Retirement Security Advice Act of 2001.

At the outset, I want to commend you, Mr. Chairman, for scheduling this important hearing and to thank Chairman Boehner for his commitment and leadership in seeking to ensure that working Americans have the advice they need to enable them to plan for a secure retirement. Mr. Andrews, I know you recognized the need to address this issue as well, and I look forward to working with you and all the Members of the Subcommittee to fashion a bipartisan solution to this important issue.

Meaningful investment advice is more important now than ever because of the increasing number of workers who have responsibility for the investment of their pension plan assets. Their retirement security will depend on how wisely they exercise this responsibility. Let me assure you that we at the Department are very serious about our responsibilities to protect plan assets from abuse. We believe this bill creates a strong protective framework for the provision of investment advice for participants, and look forward to working with you and all interested parties in achieving this important goal.

With 401(k) plans now holding an estimated 1.7 trillion dollars in assets, and many of them providing more than ten investment options from which to choose, the importance of providing participants with assistance in making informed and appropriate investment decisions cannot be overstated. Because the original ERISA statute did not contemplate the need for a means to provide investment advice efficiently to individuals, we support legislative amendments to accomplish this result.

Most employers are not in the business of providing financial services, yet they understand that the decision of whether and how to provide advice to their participants is a fiduciary action under ERISA. Therefore, it is reasonable to expect them to proceed with considerable caution. Many employers have expressed concerns regarding the appointment of an advisor for their planned participants, for fear of assuming fiduciary liability for the adviser's actual individual recommendation. Some have expressed the fear that their responsibility could extend to monitoring every recommendation given to every participant. Unless we satisfactorily address these and other employer issues, they will inevitably refrain from making advice available, regardless of any other steps we may take. And unless employers are willing to offer advice services, our objective, getting advice to participants and beneficiaries, will be frustrated.

The exemption process also comes into play in the advice arena because ERISA prohibits fiduciary investment advisors from engaging in transactions with clients' plans where they have a conflict of interest. As a result, investment advisors cannot provide specific investment advice to 401(k)-type plan participants about their own firm's investment products without a prohibited transaction exemption from the Department.

The current situation of some unaffiliated advisors with no need for an exemption, some affiliated advisors with an exemption, and the rest prohibited from providing advice has created a situation that is disadvantageous to participants. The time it takes to receive an exemption and the conditions imposed by the Department have meant that affiliated providers often cannot participate in market innovations, resulting in fewer choices being available to participants and beneficiaries. As a result, we do not believe that individual prohibited transaction exemptions are the best way of addressing this problem.

The Retirement Security Advice Act recognizes that the plan is often a participant's best source of investment advice. This bill would afford average plan participants access to fiduciary advisors who are regulated by Federal or State authorities and who must act solely in the interest of plan participants and beneficiaries. It would provide extensive information to participants about fees, relationships that may give rise to conflicts of interest, and limitations on the scope of advice that may be provided. The bill would also require that any purchase or sale of securities in connection with the

advice occur solely at the direction of each participant.

We believe these and the other protections in the bill create a basic framework for assuring that advice is fairly and appropriately provided, and we welcome the opportunity to work with the Committee to ensure that these protections are adequate.

The bill also recognizes that employers are understandably concerned about their roles in selecting and monitoring investment advisors for their plan participants. The bill specifically clarifies that such duties do not extend to monitoring the specific advice given by the fiduciary advisor to any particular participant. We believe such clarification will lead to broader availability of participant investment advice, and we will work with the committee and plan sponsors to ensure that they are willing to make advice services available.

In conclusion, the Administration fully supports your efforts to deal with this important issue and seeks the same objectives as those proposed in your bill: strong protections and certainty for participants, employers, and service providers, a level playing field, greater choice among advisors, and the expansion of needed investment advice for participants and beneficiaries in 401(k)-type plans. We commend the Committee for its leadership and look forward to working with you and your staff on this important legislation.

Thank you again, Mr. Chairman, for the opportunity to present our views on this important legislation, and I will be pleased to answer any questions you or the members of the Subcommittee may have.

WRITTEN STATEMENT OF THE HONORABLE ANN L. COMBS, ASSISTANT SECRETARY FOR PENSION AND WELFARE BENEFITS, U.S. DEPARTMENT OF LABOR, WASHINGTON, D.C. – SEE APPENDIX C

Chairman Johnson. Thank you, we appreciate your testimony. Thanks so much for coming over.

Let me ask you a question to start with. Under the bill, financial advisors would owe plan participants the fiduciary duty to act solely in the best interest of the workers they are advising. Can you expound upon what this would actually mean, and how would you and the Pension and Welfare Benefits Administration enforce this?

Ms. Combs. Well, you are correct that a fiduciary has an obligation to act solely in the interest of plan participants and beneficiaries, and the courts have interpreted this to mean that they have to act only in the interest of the participants with complete and undivided loyalty. They may not act in their own interest. It has to be only in the interest of the participants.

In other words, in this context, that would mean that the fiduciary advisor would have an obligation to give unbiased, quality advice and would be prohibited from acting in its own interests by trying to, for instance, steer investments into a fund where it might

make higher fees. That would be prohibited under the fiduciary standard. The fiduciary standards are the bread and butter of what PWBA does in its enforcement effort. We have a long track record of enforcing the "prudent" standard and the "solely in the interest" standard under ERISA. We monitor and investigate and litigate against service providers in general, and financial service providers in particular. We have over the years, and we would continue that effort and make sure that the protections that are put in place in this bill are enforced.

We also would work with other regulators such as the FCC, who would have a role here in enforcing these standards, as they apply to the license of people who would be available to give this advice, such as the state insurance commissioners in the context of insurance companies. So we would expect to work with other regulatory agencies. And we also rely heavily on plan participants in our enforcement efforts. We get a lot of questions, comments, tips, frankly, from plan participants. We would use that as another means of making sure that we were on top of this issue.

Chairman Johnson. Thank you. I wonder if we could talk about the duty that this bill imposes upon employers. As you know, this legislation subjects employers to a fiduciary duty in their selection and oversight of investment advisors. Can you describe to us exactly what employers would have to do to satisfy this duty?

Ms. Combs. Employers have similar obligations to monitor and select other service providers or investment advisors they may use at the plan level. So I believe that they are familiar with the types of responsibilities that come with this duty. They would have to look at such things as the qualifications of the fiduciary advisor. They would have to review the terms of the legislation to make sure that the advisor was in compliance with the standards that were laid out in the statute. I think they would have to periodically monitor the performance of the advisor, and certainly pay attention to any comments or complaints they received from their workers about the advice that they were being given.

These are responsibilities that employers have in other contexts that they are able to fulfill. I think they would be able to meet the standards in this bill.

Chairman Johnson. Thank you very much. The Chair recognizes Mr. Andrews for questions.

Mr. Andrews. Thank you. Thank you, Madam Secretary. I appreciate your testimony.

Under the bill as it is presently before us, if an employer on the first day of the employee's job gives the employee a booklet that explains the 401(k) plan, and buried in a 300-page booklet there is a disclosure that some of the funds that the employee can choose for her 401(k) are funds for which the investment advisor receives a higher commission or some other benefit. It is the only disclosure that takes place, and a year and a half later the employee decides to put her 401(k) assets into one of those funds. Is that disclosure adequate under the bill as it is before us?

Ms. Combs. My understanding of the bill that is before you is that that disclosure probably would not suffice, and I would say I don't think it should be sufficient.

Mr. Andrews. You don't think it should?

Ms. Combs. The bill, as I understand it, would require clear and conspicuous disclosure of the conflicts of interest that were involved, and I think we would interpret that in terms of our regulatory authority to be more than big type.

Mr. Andrews. One of the concerns that I have about the bill is on page 1 lines 22 through 25. It appears to me that the bill says that the disclosure must take place at the time of or before the initial provision of advice, and I think the facts as I have outlined them would satisfy that requirement. The disclosure would take place before the initial decision. Is it your position that we need to change that?

Ms. Combs. Well, I would like to work with the Committee on what their interpretation of that language is. Certainly we would have more authority under the statute to issue additional clarifications about the language; and in other contexts, people have interpreted "on or before" to mean within a reasonable period of time before the advice is given. As I understand, the bill also requires that the advice be kept up to date and made available to participants. But I think that this idea of having disclosure that is contemporaneous, that is clear, and people are aware of the conflicts, is a point that we all agree on, and we will work with you to make sure.

Mr. Andrews. To be meaningful, the advice needs to be contemporaneous?

Ms. Combs. I think contemporaneous with the initial provision.

Mr. Andrews. The second question I have is about the qualifications of the investment advisor. Let us assume that a bank's financial services department is serving as the advisor in this potentially conflicted situation that we are talking about, and an employee of the bank who started as a teller and worked his or her way up to the pension department is the person giving the advice. This person does not hold an SEC license, and doesn't have any certification from a private professional association. The person is simply a good worker for the institution, who doesn't have any licensure. Is that person qualified to give advice under the bill that is presently before us?

Ms. Combs. My understanding of the legislation is that it does allow agents and employees to give advice, which I think is an attempt at a practical solution to who might be actually out there. But the fiduciary advisor in that context as I understand it would be the bank, who would have an obligation to make sure as a fiduciary that the individuals giving the advice were qualified and were complying with the standards of the statute, but I would defer to the Committee.

Mr. Andrews. One thing we ought to mutually consider is whether or not that requirement should be tightened up. I appreciate the fact that the employing institution as a fiduciary is bound by the law, but as a practical matter I think we want to make sure that the individual who is providing the advice himself or herself is a competent person who is well trained and well educated.

Finally, Mr. Chairman, what I would like to ask is unanimous consent to submit for the record a letter from the prior Department of Labor when we considered this issue. I would like that included in the record as to the position of the Department last year.

Chairman Johnson. Do I hear any objection? So ordered.

SUBMITTED FOR THE RECORD, LETTER TO CHAIRMAN WILLIAM GOODLING, COMMITTEE ON EDUCATION AND THE WORKFORCE, U.S. HOUSE OF REPRESENTATIVES, FROM ALEXIS HERMAN, SECRETARY OF LABOR, U.S. DEPARTMENT OF LABOR, JULY 19, 2000 – SEE APPENDIX D

Mr. Andrews. Thank you.

Chairman Johnson. The way I read this thing, Rob, is he has to be an investment advisor. He has to be a person registered as a broker or dealer under the Securities Exchange Act, and I don't think the person you are talking about could be giving advice.

Mr. Andrews. If the Chairman would yield, the one I am making reference to is subparagraph 6 at the top of page 8. It appears to me that an employee, agent, or registered representative of any of the persons described in 1 through 5 is qualified. So even if the individual giving the advice is not qualified, I think if the institution is, then that person qualifies. That is the point that I am making. I would yield back.

Chairman Johnson. All right. But I think that can be clarified pretty easily.

The Chair recognizes Mr. Boehner for comments.

Mr. Boehner. Thank you, Mr. Chairman. I tend to agree with my colleague from New Jersey, Mr. Andrews. Prior to advice being given, it is intended that the disclosure of any potential conflicts or fees in fact be contemporaneous with the giving of the advice. As you pointed out in your "handbook" example, if conflict disclosure is buried in some 60 pages that no one is going to read or know about, this probably would not suffice.

As far as the second issue that my colleague brings up about the qualifications of the advisor, the employer has a fiduciary duty, as does their agent, to make sure that they are providing sound advice and that the people giving it are in fact qualified to give it. I will be happy to take a look at further safeguards, but I think we have to be careful that we don't overly burden either the employer or their agents and create a dynamic where it becomes so costly that nobody is going to be able to afford it.

Madam Secretary, welcome. We are glad that you are here. Now, let me get into some of the meat of this, the fun stuff, as I would describe it. We have heard from some that only independent advisors should be able to offer investment advice to workers. I guess I am going to ask you, what do you think is more important, the quality of the advice or the independence of the advisor?

Ms. Combs. Well, I believe the quality of the advice is paramount here. It is the key to what we want to accomplish. I think the overarching goal here is to get quality investment advice to participants in 401(k) plans, and that is the objective. With regard to the independence issue, there are safeguards that can be put in place, and the bill attempts to do that. We can work to make sure that it does accomplish that, in order to protect against conflicts of interest.

Frankly, I think it is becoming more and more difficult to find a truly independent investment advisor with consolidation in the financial services industry in the marketplace. Even some of the firms that have been providing independent advice are now forming alliances with affiliated advisors. It is becoming a very difficult distinction to make. I think the better focus is let us get quality advice to participants and make sure that there are protections in place so that they are not subject to conflicts.

Mr. Boehner. Many times when we get into the bowels of the legislative process, we start to speak in "legislative speak", and I am sure most people wonder what we mean by a fiduciary responsibility? You might want to spell that out. I would ask you to also spell out what the liabilities are that employers and their agents have today if in fact they violate their fiduciary duty?

Ms. Combs. Well, a fiduciary duty is the highest standard. It was developed in ERISA based on trust law. We have common law that goes back centuries in trust law, and in fact it is the highest standard because it is really a duty to act prudently and solely in the interest of plan participants. The prudent standard is a reasonable expert, so it is a very high standard. You have an absolute personal obligation, as well as the institution being liable, to act only in the interest of those participants and to be prudent and diversify investments. There are a number of standards that go under the fiduciary rules.

As a practical matter, I think this has resulted in people taking their fiduciary responsibility very seriously. It is something, as I said before, that the Department has a lot of experience in enforcing. You are subject to civil and criminal penalties. In certain circumstances, criminal penalties can arise. You are personally liable, as I said. In my prior experience with the Department, people take their fiduciary responsibility very seriously when we bring cases.

One of the powers the Department has is to remove someone and prohibit them from serving as a fiduciary in the future. It is something that folks take very seriously and work very hard to avoid. I do not think it is a standard that people take lightly, and certainly it is not a standard that we take lightly.

Mr. Boehner. Well, I can tell you from personal experience that when lawyers presented my plan documents for me to sign in the late seventies when I was setting up my pension and profit-sharing plan, both defined contribution plans I might add, I had to read the fiduciary duties and what my obligations were under it. I was almost scared to death to actually sign this document, considering that I personally was going to be responsible for the outcome in the operation of this plan for the benefit of my employees.

Thank you. Mr. Chairman, I will yield back the balance of my time.

Chairman Johnson. The gentleman's time has expired.

Mr. Boehner. I knew you couldn't wait to say that.

Chairman Johnson. I know. The Chair recognizes Mrs. McCarthy for questions.

Mrs. McCarthy. Thank you, Mr. Chairman, and thank you for your testimony. I know there are many people here who certainly are concerned about the way the bill is written, and I think all of us agree that we want to do the right thing.

You know unfortunately, last year we saw our entire pension plans, 401(k)s and Thrift Savings go down, and yet we are seeing more and more people going into the market. Certainly I am looking at my pension plan and I am glad I didn't retire this year. I guess that is what we are concerned about, because more and more people are going into it.

Also one of the concerns that I have heard is that a lot of our people out there are not sophisticated enough to get that information. My kid brother is a boilermaker. He has his pension money certainly looking toward his future. Actually, he is doing much better than I am. But with that being said, an awful lot of his co-workers spend a lot of time looking at how they should invest their money. To be honest today versus 30 years ago when my parents were counting on only their Social Security check that is basically what they thought they would retire on. We know we can't do that anymore. But to be very honest with you my husband was a stockbroker and there is no such thing as going into any market without some sort of risk.

What it comes back to with this bill is we are trying to work out the right thing to give all of our workers the protection they need. Can we write a perfect bill? No, we cannot. Can we control the markets? No, we cannot, but I am hoping that this Committee can work out something that will be fair for everybody, because I would tend to think everybody here is for Thrift Savings. What we see throughout this country are employees they want to make smart investments. The reputation of advisors is on the line, and the more we give people information to understand, the better it is.

Now, basically the only question I have for you is what is the average cost of providing investment advice to a participant, and who bears this cost? Is it the plan and thereby the participant?

Ms. Combs. I don't have a number for the average cost, I will supply that to you for the record, but the cost can be borne by the plan sponsor. In some instances employers will pay the cost, and in other instances they will pass it through to the participant, which is one of the reasons that I think it is important that this be optional. Investment advice is something that participants have the ability to choose if they desire, but they also are not required to pay for something that they are not interested in. I believe most people will be interested.

I think your earlier comments are exactly right. We have to help people manage this money. It is increasingly their responsibility, and we need to give them the tools they need to do this, and strike the right balance to make sure that the protections are in place.

I will get information for you about the average cost. I am sure it depends on how particularized and how personal the advice is. I am sure there is a range, but we will provide that for the record.

Mrs. McCarthy. Thank you.

Mr. Andrews, when we talk about disclosure, and obviously you can see I wear reading glasses, is there anything in the legislation in bold print so some of us that are over 55 would have an easier time reading it?

Mr. Andrews. If the gentlewoman would yield, I can't speak to what the legislation means because I didn't write it nor am I a sponsor of it. I would note the word "conspicuous" is in there. Depending on how one interprets that word, it doesn't say, “in bold print”, but it does say conspicuous.

Is that right? Mr. Boehner left? His spirit is with us, and I think that was what he was saying.

Mrs. McCarthy. Maybe that is something we could do? I yield back the balance of my time.

Chairman Johnson. Thank you. The Chair recognizes Mr. Fletcher for questions.

Mr. Fletcher. Thank you, Mr. Chairman.

We have met, Madam Secretary. Congratulations and thank you for being here today. I have a question with two parts.

How important do you think it is, as a matter of long-term policy, to make investment advice broadly available to workers, and what are the long-term benefits of this bill?

Ms. Combs. I think this is one of the most critical issues we face in terms of long-term policy. We have a situation where our retirement system has changed dramatically in the past 10 to 15 years, from a system where the typical pension plan was a defined benefit plan, where professional asset managers on behalf of the employer managed the assets, and, frankly, where the employer assumed the risk of the outcome of the investments.

That paradigm, if you will, has changed, and the typical employee now is in a 401(k) or a 401(3)(b) plan, and they have responsibility for their investments, and it is a very difficult task. I think people are crying out for this help. There is a real need and a real desire to meet that need.

Anecdotally you hear of employers that have embraced the idea of providing investment education, which is a general kind of description of different investment options and asset allocations that might make sense for typical employees. That is a very good thing and it has improved the market. I think at the end of the day the employee will look at you and say, so what should I do? Employees want advice, and they need help.

I think Chairman Boehner was right; they are turning to "Bob" at the coffee shop. That is not the right answer. I think this is a critical issue.

Mr. Fletcher. Basically, what I understand is that tremendous long-term benefits to employees will be there because of the advice.

Under defined benefit plans, the folks that are responsible for investing the money obviously broker through individuals that have some sort of interest in selling things. We allow the individuals that are managing those defined benefit plans to give advice, et cetera, but we restrict employees. It appears to be a fairness issue. Do you have any comments on that?

Ms. Combs. Well, employers select investment advisors. There are restrictions on conflicts of interest at the employer plan level as well. But employers are generally sophisticated purchasers of investment advice, and they contract with professionals and, as I said, they bear the risk. So some plans manage the money in-house. Most of them hire professional investment advisors and delegate the fiduciary authority to them.

But I also think it is a fairness issue. ERISA, as I said in my statement, was not drafted in a world where 401(k) plans even existed. So Congress didn't really think about how to deal with the situation where an individual is being asked to take on this responsibility. And in terms of the long-term benefit, not only is it a critical need, but I think by opening up this market and letting in more competition, we will get more better quality advice and lower costs, which I think is a good thing.

Mr. Fletcher. Thank you, Madam Secretary, and I yield back.

Chairman Johnson. The Chair recognizes Mr. Tierney.

Mr. Tierney. Thank you, Mr. Chairman. I want to thank you for joining us today.

Let me ask this question first. Before you had your current position, you were working with the American Council of Life Insurance?

Ms. Combs. That is correct.

Mr. Tierney. In that position, you were a strong supporter of the bill as it was filed last year; am I right?

Ms. Combs. The Association supported the bill, yes.

Mr. Tierney. What was your personal role in the drafting of the bill?

Ms. Combs. ACLI, along with a number of financial service providers, were very involved in working with the Chairman and the Committee in developing the legislation. I would just say that I am very aware of the different hat that I wear in this context, and that my mission, my goal, and my obligation is to the plan participants and beneficiaries

and not to the financial services industry.

I do think my experience has given me some insight into the industry and will allow me to be an effective regulator. I also would just point out that my comments here are not my own. They are the Administration's.

Mr. Tierney. Fine. What was your role in drafting the legislation?

Ms. Combs. We participated with the Committee in helping them develop it and in helping to draft the legislation.

Mr. Tierney. I don't know what "we" is, but I was asking about you.

Ms. Combs. I was the Vice President for Retirement, and I was personally involved in it.

Mr. Tierney. And what was your role in the drafting of the legislation?

Ms. Combs. I had outside counsel retained. I worked with them. We provided draft language that the Committee reviewed, sometimes took, sometimes didn't take, and we provided comments as the bill was being developed.

Mr. Tierney. Okay. Thank you.

One of the things that concerns me, as somebody mentioned, is wanting to protect people, and then in 1974 the whole pension protection law was passed. As one article recently said, after kickbacks, sweetheart deals, and outright looting cheated millions of Americans of their pension money, it made the United States the guarantor of last resort. I would hope whatever we do here keeps that history in mind and sets up some protections against getting us right back into that situation.

Ms. Combs. Absolutely.

Mr. Tierney. Do you think requiring that any advisor be a trained retirement advisor would strengthen the bill?

Ms. Combs. I think my understanding is the bill attempts to do that by requiring that these people be licensed security advisors.

Mr. Tierney. But not retirement advisors? It speaks more broadly than that. Do you think having them be trained retirement advisors would strengthen it?

Ms. Combs. I am not sure that there is such a certification.

Mr. Tierney. I am not talking about certification. I am talking about training and background experience.

Ms. Combs. I would expect that the firms, in order to fulfill their fiduciary obligation, would have to make sure that the people giving the advice were familiar with retirement

objectives, and I think that would happen.

Mr. Tierney. Do you think requiring that would strengthen the bill?

Ms. Combs. Well, I would defer to the Committee's judgment on that.

Mr. Tierney. Well, since you were the witness, I was just looking for your opinion. Is that something you care to share with us?

Ms. Combs. I would like to think about it. I am not sure how it all plays out, but certainly it is something we could consider. I think we are open to ways to strengthen the bill, and if spelling out that training in specific retirement objectives is essential, we could consider that.

Mr. Tierney. Now, my understanding of the bill, and please correct me if I am wrong, is that it doesn't really permit individuals to select independent advisors. In other words, they are stuck with the advisors that the employer chooses. Am I right?

Ms. Combs. Individuals would still be free to go out and hire someone totally on their own. There is nothing that prohibits them from doing that, but the way the bill is structured, what it does is it allows employers to offer advisors who have relationships with the investment options.

Mr. Tierney. As long as the employers were going to provide an advisor, wouldn't the bill be strengthened by requiring that they provide an array of advisors so that there be some choice by the employee as to whom they would get to advise them?

Ms. Combs. I think that is a question of balance, and a kind of a cost/benefit analysis. I think there is merit in that. On the other hand, if you are looking at smaller employers, they are going to want to deal with one person. I mean, if you put burdens on them by requiring them to offer several investment advisors and monitor them that may show their willingness to offer advice. Again, we will take it under consideration. I think it is an interesting idea.

Mr. Tierney. Well, one other point I wanted to make, before my time runs out, is you have a situation where the employer provides the advisor. The advisor is not required under the bill to give advice about the company's own plan, and the company's own stock. That may be one of the things that the employer provides the opportunity to invest in. I say this, because I have a Lucent plant in my district, where the stock has gone from about $67 last year to about $5 now, and it has been a real problem for people that were invested heavily in Lucent technology stocks.

I think it might be beneficial if the advisors could advise on the stock of a company, if that was one of the selections offered, if they had an array of advisors to choose from, rather than just the employer's. I hope that would be something that we would look into. I would like your opinion as to whether you think that might strengthen people's trust if those things were available?

Ms. Combs. My understanding of the reason the bill allows people to limit what they give advice on, and not give advice on employer securities, was they may feel that they are not really in a position to opine on the benefit of employer securities. That being said, I think that is an issue to be discussed, and I think the history, or the experience we have had so far with investment education, has shown that when people do get investment education, they tend to move out of employer securities. They understand the need for diversification better, and I think that could be the result of giving education and advice. People would look carefully at employer stock and where they fit into their retirement portfolio, and make a better-informed decision that may be appropriate for them, but they may decide they would like to diversify.

Mr. Tierney. Thank you. Thank you, Mr. Chairman.

Chairman Johnson. Your time has expired. I would just like to point out that you were asking about the witness' qualifications.

Mr. Tierney. I don't think I questioned her qualifications, Mr. Chairman, just so we all talk about the same set of facts.

Chairman Johnson. The Senate approved her 98 to zip, and they get into those things more deeply than we do as far as a person herself.

Mr. Tierney. That may be the case, Mr. Chairman, but just so you and I are clear, when I think a witness' past experience or bias or interest in an issue is important, I will ask the question and get the information.

Chairman Johnson. That is fine. That is your job.

Mr. Tierney. Thank you.

Chairman Johnson. But let me also point out that this program is voluntary, and I think specific numbers of advisors by each employer is getting a little bit too much. When you say "financial advisor," you know, those guys jump through a lot of hoops to get all those ratings in the financial industry today; and to call a guy a financial advisor, I think he is well qualified to advise without prejudice. I don't know how we would tighten it up any more than the bill already does, unless you have some specific suggestions.

Mr. Tierney. Well, I thought I gave you a couple of leads there, but if you are not willing to take them or consider them, that is up to you, but we can certainly talk about that. I happen to think letting people advise on every stock that was offered, even employer stock, would strengthen the bill. If employees felt that the single advisor provided was not to their liking, as long as it was going to be bought and paid for, they have the choice to get somebody else.

Chairman Johnson. Well, you understand why the employer stock was omitted in particular, don't you? They didn't want any fraudulent behavior going on there.

Mr. Tierney. It cuts both ways.

Chairman Johnson. No kidding. Mr. McKeon?

Mr. McKeon. Thank you, Mr. Chairman. I want to thank the Secretary for being here this morning. I appreciate your input on this very important bill. I want to thank the Chairman, the Subcommittee Chairman, and others who are working on it for bringing forth this bill.

I don't have a question, but just a brief comment. I am over 55, and I have been around a long time. And many years ago I sold life insurance, and actually had my NASE license and sold mutual funds. I know that the market goes up and the market goes down, and I know there is a lot of concern right now because people saw their 401(k) got down last year. Some of these people have never seen the market go down. In the last several years, we have just had this unprecedented increase.

I remember as a young man, the Vice President of the insurance company that I was working for came and gave us a talk, and said that they thought there was a very good chance that in the next couple of years the Dow could reach a thousand. Now, that happens, you know. It goes up and down a thousand within a few months, and it was many, many years before it ever hit a thousand. So these changes come, and they go. The market goes up and down.

But many of the people that are investing don't have that experience, and it is very important that they do have the opportunity to have some counsel and wisdom. I hope that we can work out the differences in this bill and get it passed, because I do think it has great benefit for the people that need it the most.

And with that, I yield back my time, Mr. Chairman.

Mr. Boehner. With reference to my good friend from Massachusetts, Mr. Tierney, who may not have been here when I gave my opening remarks, sometimes we so protect employees that they have got no place to turn. For the average 401(k) account, which is in the $42,000 range, there are insufficient funds or incentives for the holder of one of those accounts to go out and hire an investment advisor on their own.

We believe that, yes, there is some risk associated with opening this up. But as I mentioned earlier, I would argue that there is far more risk to the worker by not offering them the kind of investment advice that they so desperately want and employers want to help them get. We are trying to find a way to get this advice to employees in a safe and prudent manner.

If you have issues with or improvements to the bill, we are happy to take a look at them. But I think there is a balance there that does in fact work.

I would be happy to yield if the gentleman from California has the time. Does the gentleman yield?

Mr. McKeon. I yield to the gentleman.

Mr. Tierney. I was here for your opening and was mesmerized by it.

Mr. Boehner. Don't you all appreciate the new tone and atmosphere here in the Committee?

Mr. Tierney. The fact of the matter is that I would just hope that we would look for a way that does all of the things that you state, and I think one way to do that would be to minimize any potential for conflict.

I think that sometimes, as I read the bill, it seems to be setting it up where we would expect the advisors to be in a conflicted situation that hopefully would be leaning the other way to sort of lead to advisors that either weren't in a conflicted situation or to set up some safeguards in case they abuse that situation.

And I think the bill can be worked in that way, and I think those are what my questions are guided towards. I don't think it should take a lot of heavy lifting. I am here to learn and listen. But those are concerns that I want both of my questions to express, and hopefully we will hear some of the answers.

Mr. Boehner. Thank you.

Mr. McKeon. Reclaiming my time, the final point I wanted to make is that now would probably be the worst time to bail out. When the market is up high, the tendency is to think it is going to go on forever; and then when it drops that is the worst time for people to sell. So I just want to make sure, as you move forward, that we do give people the opportunity to get good advice.

Mr. Boehner. If the gentleman will yield again, we have centered this debate so far today on those possibilities of getting very risky investments or bad advice. But how about those millions of Americans who have substantial assets in their 401(k) accounts, who keep their money locked up in a money market account, getting a very low return on their investment? It is as big a problem as those who have over-invested in one particular sector of the economy.

If we are going to help people maximize their retirement security, giving them good, solid advice to get them a good solid return over a long period of time, is in the best interests of all of us and all American workers.

Chairman Johnson. Thank you. Again, the gentleman's time has expired.

Thank you, Ms. Combs for being with us today. We appreciate your coming.

I am sorry. I didn't see you come in. Do you care to question?

Ms. Rivers. No, thank you.

Chairman Johnson. Thank you. And I hope we see some more of you in this Committee. I am sure that we can work with you in any way we need to. Thank you so

much for being here today.

Would the other witnesses be seated as she departs, please?

Our first witness on the panel is Mrs. Betty Shepard, Human Resources Administrator for Mohawk Industries, Inc., in Kennesaw, Georgia. Mohawk Industries is the second largest carpet manufacturer in the world. Next to her will be Mr. Damon Silvers, Associate General Counsel for the AFL-CIO here in Washington. He works closely with the AFL-CIO's Office of Investment and the Center for Working Capital on such issues at securities law and benefit fund investment policy. Following him will be Mr. Richard Hiller, Vice President of the Western Division for TIAA-CREF. He is responsible for the delivery of those products and services from Chicago to Los Angeles. And after Mr. Hiller will be Mr. Joseph Perkins. He is immediate Past President of AARP. Our final witness for today is Mr. John Breyfogle, Principal at the Groom Law Group. He will be testifying on behalf of the American Council of Life Insurers. Mr. Breyfogle's practice includes counseling financial organizations and plan sponsors on compliance with ERISA's fiduciary and prohibited transaction requirements.

Let me again remind the witnesses that under our Committee rules they must limit their oral statements to 5 minutes, but your entire written statements will appear in the record.

Ms. Shepard, you may begin with your testimony. Thank you.

STATEMENT OF BETTY SHEPARD, HUMAN RESOURCES ADMINISTRATOR, MOHAWK INDUSTRIES, INC., KENNESAW, GA

Good morning, Chairman Johnson, and Ranking Member Andrews. I thank you for the opportunity to comment on H.R. 2269, The Retirement Security Advice Act, and the importance of enhancing the law to enable plan sponsors to provide professional investment advice to plan employees.

My name is Betty Shepard, and I serve as the Human Resources Administrator for Mohawk Industries, Inc. Mohawk Industries is the second largest carpet manufacturer in the world with its headquarters located in Calhoun, Georgia. We currently employ approximately 25,000 people, 90 percent of whom are hourly production workers. Included in our employee base are a large number of Spanish-speaking employees. Because of our employee demographics, providing information and education on plan rules and investments has been challenging and often unsatisfactory.

We feel our benefits programs are among the most competitive in the industry. In particular, we are very proud of the retirement plan that we make available to our employees. We are the plan-sponsor for the Mohawk Carpet Corporation Retirement Saving Plan, which offers employee-pretax, employer matching and profit sharing

features.

Our plan has assets of approximately $223 million, representing the accounts of over 21,000 employees. The plan offers 11 investment options in all major asset classes including Stable Value, Bonds, Balanced Funds, Large and Small Cap Funds, International Funds and Mohawk Company Stock. Our annual profit-sharing contribution is made in Mohawk Stock and can be directed by the employee to other investment options in the plan.

Mohawk utilizes the services of a bundled record keeper to handle the daily administration of our Plan. The record keeper has a department dedicated to helping us educate our employees about the plan. We work extensively with them to promote education relative to participation, retirement planning, asset allocation, and diversification. In fact, the education materials that were developed for our employees won industry awards for content and the presentation of information on the plan parameters and investing basics.

Despite our significant efforts to provide the necessary tools for employees to make investment decisions, they continue to look to us to provide specific investment advice. Due to the substantial fiduciary liability associated with the delivery of specific advice under current law, we do not offer access to advice on investment choices to our employees. While Internet-based services can assist many plan sponsors, we do not feel that this will adequately address our employees' needs, as the majority of our employees do not have access to the Internet at home or at work.

Currently, the assets of our plan are invested by employees as follows: 36 percent - Stable Value; 2 percent - Bonds; 7 percent - Balanced Funds; 41 percent Stock Funds; 9 percent Company Stock; 5 percent Participant Loans.

As you can see from our plan asset allocation, our employees invest predominately in either stable value funds that may not keep up with inflation, or they are heavily weighted in stocks that have a greater risk for loss of principal. We continue to provide education in the form of face-to-face meetings and mailings to the employees' homes, but this is not meeting employee needs and does not satisfy their requests or concerns.

I come before you today in support of The Retirement Security Advice Act and ask that you and your colleagues pass this very important law so that we can provide our employees with the professional investment advice that they need to make good, sound investment decisions.

Without this assistance, I fear that many of our employees may overreact to market fluctuations and listen to the commentary of family, friends, or the media, who are not investment professionals, to make retirement planning decisions. This unprofessional advice can lead to many employees having smaller nest eggs than they will need to live comfortably in retirement.

Some critics opposing this bill have stated that changes to ERISA would reduce the fiduciary obligations of plan sponsors or that conflicts of interest could arise with

financial service providers. Our fiduciary obligations do not disappear with this bill. Plan sponsors, such as Mohawk, will remain responsible for the selection and the monitoring of individuals that we entrust with delivering unbiased advice to employees.

In closing, I want to thank you again for this opportunity to testify and to stress that our employees need assistance in directing their investments. We commend Chairman Boehner for introducing this very important bill that would enable us to provide our employees with the information that they need to save wisely toward their retirement.

I am pleased to take questions at this time.

WRITTEN STATEMENT OF BETTY SHEPARD, HUMAN RESOURCES ADMINISTRATOR, MOHAWK INDUSTRIES, INC., KENNESAW, GA
SEE APPENDIX E

Chairman Johnson. Thank you, ma'am. We will ask questions after everyone has testified. Thank you so much for your testimony.

Mr. Silvers, you may begin your testimony now.

STATEMENT OF DAMON SILVERS, ASSOCIATE GENERAL COUNSEL, AFL-CIO, WASHINGTON, D.C.

Thank you, Mr. Chairman. My name is Damon Silvers. I am an Associate General Counsel of the American Federation of Labor and Congress of Industrial Organizations.

On behalf of our member unions, their 13 million members and more than 2 million retirees, I would like to thank you Mr. Chairman and this Subcommittee for the opportunity to testify on the important question of how to improve the information available to workers and retirees who participate in 401(k) plans and other self-directed retirement plans.

The AFL-CIO is strongly in favor of ensuring that the participants in 401(k) plans and other self-directed plans receive the best possible advice on how to invest their retirement money. We support codifying the Department of Labor's Interpretative Bulletin 96-1, which makes clear that ERISA neither limits plan expenditures on investment advice nor makes employers liable for the particulars of the advice given their plan participants, the very concerns that the previous witness just addressed.

Unfortunately, H.R. 2269, the bill that is the subject of today's hearing, ties this needed reform to an ill-conceived and narrowly self-interested effort by the investment management industry to weaken ERISA safeguards against conflicts of interest in

investment advice. But these two questions, employer liability and conflicted advice, are completely separate and should be evaluated on their separate merits.

The question of whether to allow conflicted advice is, however, completely tied up with the question of how effective current disclosure-only regulation is at protecting investors against conflicted advice. And the record is not good.

Last month, the House Banking Committee, Subcommittee on Capital Markets, held hearings where Members from both sides of the aisle, led by Chairman Baker, expressed concern that the poor disclosure regime of the securities laws was allowing financial service firms systematically to steer individual investors towards stocks in companies with which the financial service firms had underwriting relationships, even when those stocks were poor investments.

The financial service industry's response was largely that investors should have known that they were receiving tainted advice, even though they were receiving it from fiduciaries, and not been so ready to make investment decisions based on their analysts' recommendations.

In light of the manifest failures of this disclosure regime to adequately protect individual investors in the securities market, it is richly ironic to suggest that at the same time this Committee of the same Congress should dismantle the substantive protections that define contribution pension plans participants now enjoy.

A second irony of the investment advice debate is that currently most major financial service companies offer independent investment advice, including industry leaders like Vanguard, Merrill Lynch and Frank Russell. Most do so through contractual arrangements with independent firms. In addition, any money management firm that wishes to offer investment advice to 401(k) plans is free to do so. It simply cannot do so to a plan where it is already offering investment management services.

The result is that according to a Deloitte & Touche study earlier this year, 60 percent of plan sponsors are currently offering investment advice to their participants and this number is growing. This data suggests that the real issue money management firms have with the current state of investment advice regulation is that they are not allowed to sell advice to plans where they can profit from influencing plan participants' investment choices.

Their position begins to make sense if one considers the economics of 401(k) money management. The difference in expense ratios between a typical large-cap equity fund and a typical actively managed equity mutual fund is around 1 percent. If, as a result of self-interested investment advice, a worker ended up paying just 1 percent more for money management services per year than he or she otherwise would have, the size of that worker's retirement account at the end of a 40-year career would be 26 percent less than it would have been otherwise. And the temptation to do this on the part of money managers is likely to be irresistible, since that similar 1 percent gap between indexed and actively managed money would generate $18 billion in incremental revenue for the firms as a whole.

There are additional problems, as the New York Times pointed out in its recent article on falling 401(k) balances, with the risk of asset allocation being subtly shifted from debt to equity. And there is very little way for anyone to be able to be sure that a 65 percent equity recommendation, rather 60 percent, is motivated by bad faith. The result, though, would be a shift in both fees and risk to the participant from the money management firm.

In response, H.R. 2269 offers little more than disclosure of conflicts. The problem, though, as Congressman Tierney has pointed out is that in the current system there is very little that any plan participant can do about a disclosed conflict other than go out and spend their money on top of the money that they have already spent through their plan to get double investment advice.

It is no wonder, then, that in the last few months financial journals and publications as diverse as Time, the New York Post and Plan Sponsor have labeled conflicted investment advice a threat to plan participants. In summary, there is no crisis in the provision of investment advice that requires the solution of allowing conflicted advice. This Subcommittee should be looking at what the real problems are and protecting beneficiaries from the danger of self-dealing.

The AFL-CIO is ready to assist the Subcommittee on this matter and thanks the Subcommittee for inviting us to appear today.

WRITTEN STATEMENT OF DAMON SILVERS, ASSOCIATE GENERAL COUNSEL, AFL-CIO, WASHINGTON, D.C. – SEE APPENDIX F

Chairman Johnson. Is it always good to have the AFL-CIO here. Your time has expired, however. Thank you.

Mr. Hiller, you may begin your testimony now. Thank you.

STATEMENT OF RICHARD A. HILLER, VICE PRESIDENT, WESTERN DIVISION, TIAA-CREF, WASHINGTON, D.C.

Thank you, Chairman Johnson, Representative Andrews, Chairman Boehner, and Members of the Committee. Good morning. I am Richard Hiller, Vice President of TIAA-CREF, a nonprofit organization with about 2 million participants that specializes in managing and administering defined contribution retirement plans, largely for educational organizations.

Today, TIAA-CREF manages over $260 billion in assets and is paying retirement benefits to about a half million retirees. For over 80 years TIAA-CREF has worked closely with the higher education community to help secure the availability of retirement plans to 95 percent of the full-time employees in higher education. The American Association of University Professors, the American Council on Education, and other higher education associations join in support of our statement.

As an organization cited as a role model when ERISA was crafted, TIAA-CREF is pleased to share our expertise with you on the Retirement Security Advice Act, which would make changes to ERISA, updating pension laws to reflect today's retirement savings environment.

Employers and pension plan service providers are currently constrained by ERISA from providing individual investment advice to workers in retirement plans. The Department of Labor's interpretive bulletin helps define how service providers can supply participants with education and guidance, but many employees need more specific investment advice.

The Retirement Security Act, H.R. 2269, introduced by Chairman Boehner, will enable employees to readily obtain advice on their retirement choices from regulated pension providers. At the same time, it affords substantial protections to employees in a carefully balanced way. While the bill provides fiduciary advisors an exemption from some restrictions of ERISA, the advisor is an ERISA fiduciary required to act solely in the interest of participants and beneficiaries and to the liabilities for acting imprudently.

Control over participant retirement accounts remains with the individual who can choose to act on the advice or not. All such advice must be accompanied by full and understandable disclosure of all fees and potential conflicts. The employer, while remaining responsible as a fiduciary for the selection of the financial advisor and for monitoring the advisor's performance would not be responsible for the specific investment advice given.

Let me explain the reasons why TIAA-CREF supports this change to ERISA. Pension choices were much more straightforward when ERISA was passed more than 25 years ago. Defined benefit plans were the corporate retirement model and 401(k) plans didn't even exist. Performance of the stock market in the mid-1970s made it a scary place for the unsophisticated investor and most people were not comfortable with investing in individual stocks and mutual funds on their own.

Times change and over the last two decades, employers and employees have embraced the defined contribution pension model. As a result, the financial expectations of workers covered by pensions and 401(k) plans have changed. TIAA-CREF has responded by offering an expanded range of investment choices and distribution options, which have considerably complicated our participants' decision-making process, and they are certainly not alone.

According to Hewitt Associates, the average participant in a 401(k) plan has 11 investment choices. Moreover, most 401(k) plans do not provide lifetime payout options in retirement, so retirees are often on their own to make sure their retirement money lasts a lifetime.

Our founding charter established financial education as an integral part of TIAA-CREF's mission. The questions we hear most often from participants are: “How should I allocate my retirement contributions?” “Will I have enough when I want to retire?” and “How should I take my retirement income, as an annuity or as a lump sum?”

For most participants, the general education and guidance TIAA-CREF provides through publications, seminars, individual counseling and interactive Web-based planning tools helps to address those questions. But that doesn't mean our participants or we should necessarily stop there.

A 1997 study of TIAA-CREF participants conducted by outside economists concluded that, and this is a quote, "Given enough education, information and experience, people will tend to manage their self-directed investment accounts in an appropriate manner," end quote. But our experience teaches us that "enough" is an ever-changing benchmark.

Choosing investments in a retirement portfolio is a crucial decision. TIAA-CREF's asset allocation software offers guidance through investment model recommendations based upon risk tolerance, time horizon and investment preferences. Through a recent study exploring the use and impact of this guidance, we found that almost two-thirds of survey participants who used our software changed their investment mix. Interestingly, most participants did not follow the software's allocation recommendation to the letter. Clearly, participants considered the guidance seriously and evaluated it in their personal context.

Personalized advice, which is advice that specifically considers the individual's situation and makes recommendations accordingly, is the next step participants want us to take. Sizeable majorities of respondents to surveys by the ACLI and by TIAA-CREF desire as much information as possible, including personalized recommendations on how to invest retirement savings. We have also found that 84 percent of participants age 55 and over want specific advice about retirement income options. H.R. 2269 would allow pension plan providers to respond positively to this growing need for retirement advice.

Trust is a crucial dimension of a participant's relationship with a financial services firm, and accountability is a key to that trust. ERISA's current fiduciary liability structure, combined with the new disclosure requirements of H.R. 2269, will provide pension plan participants with increased protection to go along with the increased accessibility of retirement advice.

With these strong protections for workers, TIAA-CREF is pleased to support H.R. 2269. Thank you.

WRITTEN STATEMENT OF RICHARD A. HILLER, VICE PRESIDENT, WESTERN DIVISION, TIAA-CREF, WASHINGTON, D.C. – SEE APPENDIX G

Chairman Johnson. Thank you, Mr. Hiller.

We have two votes at noon. I would like to finish the testimony and come back for questions after we vote, which will take about a half an hour.

Mr. Perkins, you may begin your testimony. If you could keep it to 5 minutes, we would appreciate it.

STATEMENT OF JOSEPH PERKINS, IMMEDIATE PAST PRESIDENT, AARP, WASHINGTON, D.C.

Thank you Chairman Johnson, Chairman Boehner, and Members of the Committee, my name is Joe Perkins, and I am the Immediate Past President of AARP. We appreciate the opportunity to present our views on the Retirement Security Advice Act.

Despite the growth of individual comp plans over the past two decades, many, if not most, participants still lack basic investment fundamentals. As a result, AARP shares the goal of increasing access to investment advice. However, in providing specific guidance, we should continue to adhere to ERISA's longstanding protections and not encourage plans to provide advice subject to inherent financial conflicts. The unfortunate findings of a recent survey conducted by AARP are that not many Americans are knowledgeable about financial investments. For example, just one-third could correctly answer whether diversification reduces risk.

Lack of information is not the problem. The amount of financial information available today is greater than ever before. What the individual investor needs is the ability to sort through the information.

Plans may currently provide asset allocation models that can provide participants a good road map to the plan's investment alternatives. However, many participants simply want to be told more specifically where to invest their plan funds. AARP agrees that such individualized advice can be helpful, but such advice must be subject to ERISA's fiduciary rules based on sound investment principles and protected from conflicts of interest.

Participants deserve to have access to quality investment advice, free from financial conflict. ERISA has long recognized that financial conflict gives rise to divided loyalties and thus poses the risk that actions will not be taken in the sole interests of the participant. Advice providers who stand to benefit financially from the type of advice that is given face just such a conflict.

H.R. 2269 would replace ERISA's prohibition on such conflicts with disclosure and would allow investment advice where conflict exists so long as it is disclosed. AARP believes disclosure alone is not sufficient protection or the best approach in today's marketplace.

Disclosing yet more information, which the individual would have to both understand and properly weigh, will be least helpful to the unsophisticated investor. Even with disclosure, the participant is not left with much real choice. The individual either chooses to accept advice that is subject to a conflict or no advice at all.

Financial institutions and other firms may currently provide advice to participants on products in which they do not have a financial interest. They are prohibited there. In fact, most large financial service providers have developed alliances with an independent investment advisor and this practice is growing, very definitely growing. In light of these alternatives, it is premature to weaken ERISA's current conflict of interest rules. They have served both participants and pension plans well.

Congress should first encourage advice options that are independent and not conflicted by clarifying that the employer would be not liable so long as the employer undertook due diligence in selecting and monitoring the advice provider. Encouraging independent, unbiased investment advice will better enable employees to improve their long-term retirement security while minimizing the potential for employee dissatisfaction and possible litigation.

One potential alternative may be to allow a conflicted advisor to provide advice so long as the plan also makes available at least one other alternative independent advisor on the same terms with the same conditions and the same time frame. In this way, the employee always has a choice to seek independent advice.

A second possibility may be to require a higher duty for the plan sponsor in the event the plan chooses an investment advisor subject to a conflict of interest. For example, the plan sponsor could have the added duty and added liability of evaluating the quality of the advice to determine if it is free of bias in the best interest of plan participants.

In conclusion, we commend the Committee for addressing this need. We applaud the recognition of the importance of disclosure, which is also essential. However, we urge the Committee to focus on ways to encourage employers to make available investment advice without the potential for conflicts of interest, rather than weakening current law to permit advice by those with an interest in their own financial products.

We look forward to working with the Subcommittee in further improving the ability of individuals to handle such things. Thank you very much.

WRITTEN STATEMENT OF JOSEPH PERKINS, IMMEDIATE PAST PRESIDENT, AARP, WASHINGTON, D.C. – SEE APPENDIX H

Chairman Johnson. Thank you for your testimony. We appreciate it.

And last but not least, Mr. Breyfogle.

STATEMENT OF JON BREYFOGLE, PRINCIPAL, GROOM LAW GROUP, WASHINGTON, D.C., ON BEHALF OF THE AMERICAN COUNCIL OF LIFE INSURERS, WASHINGTON, D.C.

Thank you, Mr. Chairman. My name is John Breyfogle. I am a Principal in the Washington, D.C. law firm of Groom Law Group, and I am here appearing on behalf of the American Council of Life Insurers, which is the major trade association representing the life insurance industry. ACLI strongly supports the Retirement Security Advice Act of 2001. I would like to make just a couple of summary points before commenting on the legislation itself, and I will try and do it quickly.

Three preliminary points:

There is no dispute that there is a need for advice. There is a gap that exists, and I think everybody has documented that.

The second key point, I think, is that the current system isn't solving that gap. It is not addressing that problem. Independent advisors and Internet-based advisory programs alone aren't going to result in educated participants. Full-service financial firms that administer 401(k) plans, and defined contribution plans are best positioned to solve that gap. They have the largest set of resources and the most experience in this area.

A third preliminary point is that it is undisputed that current law essentially has caused this advice gap. That is because ERISA essentially has two sets of rules that are at play here. The first set of rules is a general fiduciary rule of prudence, loyalty, and diversification that applies. And this legislation wouldn't affect that rule. The second set of rules is the so-called privilege prohibited transaction rules that flatly bar certain types of conflicts of interest, and as interpreted by the Labor Department, have essentially said that advisors can't give advice when their advice might affect the amount of timing of their compensation. So if the different investment options pay different fees, then they are prohibited from giving advice among those options, and that is really the thing that has caused the advice gap.

Also, when ERISA was adopted, Congress actually included a dozen statutory exemptions, just like the one we are debating here. In the judgment of Congress it was determined that certain conflicted transactions should still be permitted to go forward,

subject to ERISA's fiduciary rules. They also give the Labor Department administrative authority to issue their own exemptions from the prohibited transaction rules. So Congress contemplated that this was a problem. What they didn't contemplate was the shift from defined benefit plans to defined contribution plans.

So what you are debating here is really updating ERISA's prohibited transaction rules for a fundamental change in the marketplace and making the kind of choice that Congress made 26 years ago, which is that some potentially conflicted transactions are still worthwhile to permit, subject to the basic ERISA fiduciary rules.

And just to briefly summarize the bill itself, I think it is unfair to call the bill simply a disclosure-based solution. The bill keeps in place the fiduciary standards of ERISA. They apply to employers who select advisors. They apply to the advisor himself who is personally liable; his institution is liable. There is a panoply of other civil remedies that would apply in the case of bad advice. And everybody should be clear that if somebody gives advice for the purpose of increasing their compensation, for the purpose of directing somebody to the higher commission fund, that would be illegal.

It would also be true that ERISA's fiduciary rules are, in fact, higher standards that exist under the Federal securities laws. There is a private right of action. There are full compensatory damages to make plans whole. And those protections would remain in place.

There are many other protective provisions, including disclosure, which I think would be up-to-date disclosure, clear, conspicuous, arms-length rules, and reasonable compensation. These are conditions that have worked well in other DOL administrative exemptions that have been issued for conflict-of-interest transactions, as well as existing statutory exemptions. So I don't think that this bill is any big departure from groundwork that Congress, as well as the Labor Department, had laid in the 1970s, 1980s, and 1990s.

Thank you.

WRITTEN STATEMENT OF JOHN BREYFOGLE, PRINCIPAL, GROOM LAW GROUP, WASHINGTON, D.C., ON BEHALF OF THE AMERICAN COUNCIL OF LIFE INSURERS, WASHINGTON, D.C. – SEE APPENDIX I

Chairman Johnson. Thank you. I appreciate your testimony.

Members, we have two votes, a 15 and a 5. So we will start with the questioning, if it's okay with you, and then come back immediately after the 5-minute vote.

Let me ask a quick question of you, Mr. Hiller. You have been in business a long time. Can you tell me what kind of people we are trying to address here? I mean people who aren't getting the advice now and maybe aren't getting the maximum out of their investments.

Mr. Hiller. Advice has always been available to people with higher net worth. They can go on their own and secure that advice. It is the rank-and-file employees, and in our case, at educational institutions the vast majority of people who haven't had the ready access to that advice on a basis that they can easily afford, or that is easily accessible to them. Those are the people that we see.

Chairman Johnson. That is who we are trying to address right here? To try to improve their retirement benefits in the long term.

Mr. Hiller. Exactly. As we said, the investment world has gotten so much more complicated since ERISA was first enacted over 25 years ago, that people need a lot more in terms of education, guidance, and specific advice in order to meet their specific financial goals. This is the kind of advice that will help people meet their defined objectives in a way tailored specifically to their needs.

Chairman Johnson. Thank you very much. I will refrain from asking any more questions.

Mr. Andrews, do you want to question?

Mr. Andrews. I do. Thank you, Mr. Chairman.

Mr. Perkins I was interested in page 11 of your written testimony, where you make reference to an alternative to the bill that may allow a conflicted advisor to provide advice so long as the plan also makes available at least one other alternative independent advisor on the same terms and conditions for plan participants. In this way, the employee always has a choice to seek independent advice.

Mr. Perkins, who would you suggest would choose this independent advisor? Would the plan sponsor designate a certain independent advisor? How would that happen?

Mr. Perkins. Admittedly, it is a tough one. You wonder whether it would happen at all because of the fact that the plan sponsor should make that provision. Remember, AARP isn't saying that we don't want individualized investment advice. We want that. We are just concerned about an advisor that is conflicted. So in the same time frame, we would love to think that an independent advisor would be available too.

Mr. Andrews. Mr. Hiller, I realize you just heard this proposal probably for the first time sitting here. I would be interested if you have a reaction to it. If you would prefer not to do that now, I would be interested in your submitting your thoughts, as well as the other panelists, for the record.

Do you have any initial reaction to this idea?

Mr. Hiller. How the employer would select advisors?

Mr. Andrews. No, the change the bill wants to make; the general concept of permitting a plan to offer an advisor, if it also offers the option of at least one independent advisor. What do you think of that?

Mr. Hiller. Well, from our position in TIAA-CREF, we talk a lot about trust and relationship with participants in a plan, and the importance of accountability from a consultant of ours working with the participant in that long-term relationship.

We are talking about people that are contributing to a retirement plan for 30 or 35 years during their career and then are retired for an equally long time. We are talking about very long-term relationships and accountability, and the advice and education that you give people during that time is critical to maintaining their trust.

I look at the advice that we would be providing people as independent advice. It is in their best interest and solely in their best interest. And that, in turn, is the best thing that we could do if we want to keep that person's trust over that long period of time. So having additional advice required, my concern would be that it wouldn't be available to them.

Mr. Andrews. Is TIAA-CREF ever in the position that the institutions that support this bill are in? Are you ever in a position where you have an interest in either a fee or the accumulation of capital in such an account?

Mr. Hiller. All of the guidance that we provide people is included in the overall package of services that they get from us. So there is no specific fee.

Mr. Andrews. TIAA-CREF doesn't manage any of funds that it is giving advice about, does it?

Mr. Hiller. Oh, yes. We manage all of the funds that we offer internally.

Mr. Andrews. Are there differences in net earnings for TIAA-CREF from one fund to another or is it all the same?

Mr. Hiller. It is all the same. Our consultants that are providing the education and guidance up to this point aren't compensated based on which funds.

Mr. Andrews. So if I understand correctly, you are not in the situation that the private-sector institutions we talked about this morning are in; is that right?

Mr. Hiller. Well, we might not be in that situation from a compensation standpoint, but we are certainly in the position of having participants in the TIAA-CREF system that need specific investment advice that we can't provide them with today.

Mr. Andrews. I appreciate that.

Thank you, Mr. Chairman.

Chairman Johnson. Members, I think we ought to adjourn for the vote. You have about 6 minutes left, and we will be back immediately after the second vote for further questions. If all of you can remain, we would appreciate it.

The Committee stands recessed.

[Recess.]

Chairman Johnson. The Committee is back in order to continue with the questioning.

I would like to ask Ms. Shepard what you think of the fiduciary duty of the employer as it applies to this bill? You listened to the earlier testimony. The Secretary indicated it was the highest fiduciary responsibility around, so tell me what you think, please?

Ms. Shepard. Well, I think that we definitely take it as the highest responsibility. In order to maintain the confidence of our employees it is very important that we get the best possible advice for them. It would be of the utmost importance. I think other employers would feel the same way.

Chairman Johnson. Now, Mr. Silvers, do you want to comment on that, because you were lukewarm on that issue?

Mr. Silvers. Well, let me make a couple of distinctions, Mr. Chairman.

We believe that the concerns raised by Ms. Shepard regarding the ways in which, employers currently have concerns about being potentially responsible under the fiduciary doctrine for the specific recommendation of an investment advice provider are meritorious ones, and that the portion of the bill that clearly relieves employers from that obligation, from that potential liability, assuming that they make a diligent choice, use due diligence in their selection of an investment advisor for their participants, that that portion of the bill is merited and is a good idea. Employers should not have that anxiety, the one that Ms. Shepard's testimony was devoted to.

Our concern here is the application of the fiduciary duty doctrine to the money manager. The concern here is twofold. One is, I think as is amply demonstrated by the testimony in the Capital Markets Subcommittee, there is a culture on Wall Street that minimizes the importance of the fiduciary duty doctrine with respect to investment advisors generally, which has had very negative effects on individual investors in the markets outside of the ERISA context in the last several years.

Secondly, the problem with the fiduciary duty, the problem with the duty of loyalty and the duty of care, is that sole protection, in conjunction obviously with disclosure for plan participants receiving conflicted advice, is twofold. First is, if I am a participant and I think that I am getting essentially conflicted and therefore worthless advice from my fund, I have got no place to go other than doubling my money, going and

spending another slice of my money to get double advice.

Secondly, and I think more importantly, along the direction of your question, Mr. Chairman, it is very, very difficult for an individual participant or even a plan sponsor to look at the investment advice models created by a money manager and be able to conclude whether or not that money manager has, in fact, after the fact, violated that duty of loyalty. Maybe this is an abstract proposition, but that duty is almost impossible to enforce. I will give you an example of what I mean by that.

There is probably nobody in this room who can tell you whether advising a plan participant to have 60 percent of their money in equities rather than 65 percent is the appropriate thing to do. And certainly no one could prevail in a court to find, after the fact, that a money manager that advises 65 percent in equities rather than 60, absent some smoking gun memo showing bad intent, there is no way to show that one, rather than the other, is a breach of fiduciary duty.

But the fact is that if an advisor were successful in persuading plan participants to put 65 percent rather than 60 percent in equities, they would generate significant incremental fee income to themselves.

That is the danger that the prohibited transaction rule is designed to address; the general fiduciary duty doctrines. Neither those doctrines nor the disclosure requirements in the bill can fix that problem.

Chairman Johnson. Well, I am not sure that isn't a risky take on your own.

Mr. Breyfogle, would you mind commenting on that same issue?

Mr. Breyfogle. I have a couple of points.

Basically ERISA fiduciary rules originate from hundreds and hundreds of years of trust law and do impose essentially the highest duty known to law. That is a quote from a famous ERISA decision. The prohibitive transaction rules have their source in regulations that the IRS dreamed up in the late 1960s for charitable foundations. They don't have sort of that time-proven effect. And so what you are really saying is that by repealing the prohibited transaction rules that hundreds of years of trust laws never really protected trust beneficiaries, because that is really, I think, a useful analogy to make.

The other thing is, I don't think we are really worried about 60 versus 65 percent. I mean, when someone is talking about well-managed mutual funds they have just a huge overlay of protection. What we are worried about is somebody steering you for the purpose of increasing his or her compensation into inappropriate, imprudent investments. And in those situations I would agree with him on the fine point of distinguishing 5 percent. You might not be able to make that case, but that is not the case we are worried about.

The case we are worried about is the case where there are clear conflicts which act solely to increase compensation and this would be illegal. There would be a private remedy. You could get attorney's fees. You could get compensatory damages. DOL

could, in enforcement action, assess civil money penalties. They could remove broker-dealers or advisors from serving as investment fiduciaries, which would be a death knell to this whole service.

So frankly it is wrong to say that the bill is just a disclosure-based bill. The bill places its reliance on a public-private remedy scheme for trust rules that impose increasingly significant duties on fiduciaries.

Chairman Johnson. Is it totally voluntary participation?

Mr. Breyfogle. Absolutely.

One other point: Again employers are going to be an intermediary in this process helping to protect their employees. They are not going to pick fly-by-night firms. The employer, by virtue of the fact that he is not interested in his employees quitting, has got that particular thing over his head and he wants to treat them right. That is why employers carry health care insurance, and take care of retirement plans for their employees and so on.

Chairman Johnson. Mr. Andrews?

Mr. Andrews. No.

Chairman Johnson. So with your permission, we will call the hearing to a close. I want to thank each and every one of you for participating, because I know your time is valuable and your testimony is important.

If there is no further business, then the Subcommittee stands adjourned.

[Whereupon, at 12:50 p.m., the Subcommittee was adjourned.]

APPENDIX A - WRITTEN OPENING STATEMENT OF CHAIRMAN SAM JOHNSON, SUBCOMMITEE ON EMPLOYER EMPLOYEE RELATIONS, COMMITTEE ON EDUCATION AND THE WORKFORCE

Opening Statement of Rep. Sam Johnson (R-TX), Chairman of the Subcommittee on Employer-Employee Relations

July 17, 2001

GOOD MORNING. LET ME EXTEND A WARM WELCOME TO ALL OF YOU, TO CONGRESSMAN ROB ANDREWS – THE RANKING MEMBER, TO MY OTHER COLLEAGUES, AND TO OUR PANEL OF WITNESSES. THANK YOU VERY MUCH FOR JOINING US TODAY.

OUR HEARING TODAY WILL FOCUS ON THE NEED FOR RANK-AND-FILE WORKERS TO HAVE ACCESS TO HIGH-QUALITY, PROFESSIONAL INVESTMENT ADVICE.

MOST EMPLOYEES TODAY HAVE UNPRECEDENTED CONTROL OVER THEIR RETIREMENT SAVINGS, BUT LITTLE GUIDANCE IN HOW TO MAKE THEIR NEST EGG GROW.

THIS PROBLEM HAS BEEN COMPOUNDED BY THE INFORMATION AGE. WITH THE EMERGENCE OF THE INTERNET AND OTHER INNOVATIONS THAT DELIVER "INSTANT" NEWS AND STOCK UPDATES, EMPLOYEES TODAY ARE LITERALLY BOMBARDED WITH TIPS AND ADVICE ABOUT THE MARKET.

OCCASIONALLY THIS INFORMATION CAN BE HELPFUL. SOMETIMES IT'S CONTRADICTORY. AND OFTEN, IT'S JUST PLAIN LOUSY.

UNFORTUNATELY, AN OUTDATED FEDERAL LAW – A PORTION OF THE 1974 EMPLOYMENT RETIREMENT AND INCOME SECURITY ACT – OR ERISA – DENIES WORKERS ACCESS TO INVESTMENT ADVICE THAT COULD HELP THEM MAKE THE MOST OF THE FREEDOM THEY HAVE TO CONTROL THEIR RETIREMENT SAVINGS.

AS A RESULT, WEALTHY INDIVIDUALS ENJOY THE LUXURY OF BEING ABLE TO AFFORD THEIR OWN PROFESSIONAL INVESTMENT ADVICE.

CONSEQUENTLY THEY HAVE REAPED THE BENEFITS OF LONG-TERM GAINS IN THEIR STOCK PORTFOLIOS. YET WITHOUT PROFESSIONAL GUIDANCE, HOW ARE EVERYDAY, HARDWORKING AMERICANS SUPPOSED TO REAP THE SAME BENEFITS? SIMPLY PUT…THEY CAN'T.

MOREOVER, FEW WORKERS HAVE THE EXPERIENCE TO MAKE SOUND INVESTMENT DECISIONS THAT WILL PROTECT THEM FROM THE

UPTURNS AND DOWNTURNS OF THE MARKETS. MANY RANK-AND-FILE WORKERS DON'T HAVE ENOUGH TIME, CONFIDENCE, OR ADVICE TO MAKE SOUND INVESTMENT DECISIONS ON THEIR OWN. THE LAST 12 MONTHS ROLLER COASTER SERVES AS THE PERFECT EXAMPLE.

LAST YEAR, POPULAR 401(K) RETIREMENT SAVINGS PLANS LOST MONEY FOR THE FIRST TIME IN THEIR 20-YEAR HISTORY, DESPITE THOUSANDS OF DOLLARS IN NEW CONTRIBUTIONS. AND AS THE NASDAQ SLIPPED, MANY WORKERS SUFFERED SIGNIFICANT LOSSES – IN SOME CASES, ACTUALLY JEOPARDIZING THEIR RETIREMENT.

IT STANDS TO REASON THAT MANY OF THESE LOSSES COULD HAVE BEEN PREVENTED IF EMPLOYERS WERE PERMITTED TO PROVIDE WORKERS WITH ACCESS TO INVESTMENT ADVICE TO COMPLIMENT THEIR EMPLOYEE-RETIREMENT PLANS.

WE'VE AUTHORED BIPARTISAN LEGISLATION – H.R. 2269, THE RETIREMENT SECURITY ADVICE ACT – THAT WOULD REMOVE FEDERAL OBSTACLES TO EMPLOYER-PROVIDED INVESTMENT ADVICE.

THE MEASURE INCLUDES RIGOROUS SAFEGUARDS TO SHIELD EMPLOYEES AGAINST ABUSE AND MAINTAINS TOUGH PENALTIES FOR ANY ADVISOR WHO FAILS TO ACT SOLELY IN THE INTEREST OF THE WORKER.

THIS MEASURE WILL HELP GIVE PEOPLE PEACE OF MIND AS THEY PREPARE FOR THE TIME THEY NO LONGER HAVE TO GO TO WORK EVERYDAY.

I LOOK FORWARD TO HEARING ABOUT THESE AND SIMILAR ISSUES OF IMPORTANCE FROM THE ASSISTANT SECRETARY AND OUR OTHER WITNESSES THIS MORNING. AS EMPLOYEES GAIN GREATER AND GREATER CONTROL OVER THEIR RETIREMENT SAVINGS, THE IMPORTANCE OF CREATING AN INFORMED, INVESTMENT-MINDED WORKFORCE HAS NEVER BEEN MORE APPARENT. HIGH QUALITY, PROFESSIONAL INVESTMENT ADVICE MUST BE READILY AVAILABLE. LET'S CLOSE THIS ADVICE GAP TO ENSURE THAT EVERYONE CAN PURSUE THE AMERICAN DREAM, NOT JUST A SELECTED FEW.

APPENDIX B - WRITTEN STATEMENT OF CHAIRMAN JOHN BOEHNER, COMMITTEE ON EDUCATION AND THE WORKFORCE

Opening Statement of Rep. John Boehner (R-OH)
Chairman, Committee on Education and the Workforce
Before the Subcommittee on Employer-Employee Relations
on
H.R. 2269, The Retirement Security Advice Act

July 17, 2001

Good morning. Let me extend a warm welcome to all of you, to the ranking member, Mr. Andrews, and to my other colleagues. I'd like to thank my friend from Texas and the chairman of this subcommittee, Congressman Johnson, for his indispensable leadership and support on this issue.

We are living in interesting times. When ERISA was signed into law 27 years ago, fewer than 1 in 5 American families invested in the stock market; today that number is closer to 1 in 2. No one then could have imagined that the Dow Jones Industrial Average would have increased by 1800 percent, as it has. Nor could anyone last year have imagined a year ago that 401(k) accounts would have lost money, as we found last week.

This is a bill that's meant for interesting times – when opportunities are significant but risks are clear. As the market volatility over the last several months has shown, investment decisions need to be based on solid and experienced judgment. In fact, a report by Cerulli Associates showed that popular 401(k) retirement savings plans lost money for the first time in their 20-year history.

Nevertheless, outdated federal law -- part of the 1974 Employee Retirement Income Security Act (ERISA) – creates powerful and unnecessary obstacles for high-quality investment advice provided through an employer. Last year, this subcommittee held extensive bipartisan hearings on ERISA's investment rules, and the need many workers have for quality investment advice immediately came to the fore.

To most people in 1974, personal savings meant a bank account. Now it means 401 (k)s, IRAs, annuities, mutual funds, and a whole range of investment products that go well beyond what was available to the average American 25 years ago. The authors of ERISA never contemplated 50 percent of American families owning stocks and could not even have anticipated 401(k)s.

Wealthier Americans can contend with the advice gap by hiring an investment advisor. But few working families can afford such a luxury on their own.

Employers and workers agree there's an obvious solution to this dilemma: Allow employers to provide their workers with access to high quality, conflict-free

investment advice.

The bipartisan Retirement Security Advice Act would update the law to allow employers to provide their workers with access to high-quality professional investment advice as long as the advisers act solely in the best interests of the workers they are advising and as long as they fully disclose their fees and any potential conflicts.

It would modernize ERISA by maximizing competition in the investment advice market, clarifying employer liability and federal rules, and ensuring severe penalties for abuse and conflicted advice.

The bill retains safeguards and includes new protections that protect employees against conflicted advice. It requires that advice be provided by a "fiduciary-adviser" who would be personally liable for any failure to act solely in the interest of the worker.

Investment advisers will be subject to the highest form of fiduciary duty under the law, including civil and criminal enforcement by the Labor Department. Securities and state insurance law protections will continue to apply as well. In addition, advisors would have to disclose any potential conflicts to plan participants.

I believe that this legislation will give workers the kind of protections they need, but will also a competitive, dynamic marketplace to develop ways of offering investment advice in a way that serves worker needs.

If we want to truly maximize retirement security opportunities, access to high-quality investment advice is critical. **Employees want this service and employers want to provide it.** I look forward to working with Chairman Johnson, my friend Mr. Andrews, and my other colleagues on the Committee to pass this legislation.

APPENDIX C - WRITTEN STATEMENT OF THE HONORABLE ANN L. COMBS, ASSISTANT SECRETARY FOR PENSION AND WELFARE BENEFITS, U.S. DEPARTMENT OF LABOR, WASHINGTON, D.C.

Testimony of Assistant Secretary Ann L. Combs

Pension and Benefits Administration, U.S. Department of Labor

Before the Subcommittee on Employer-Employee Relations

July 17, 2001

Chairman Johnson and distinguished members of the Subcommittee, I am Ann L. Combs, Assistant Secretary for Pension and Welfare Benefits at the U.S. Department of Labor. The Pension and Welfare Benefits Administration is the agency responsible for administering and enforcing Title I of the Employee Retirement Income Security Act - ERISA, the primary Federal statute governing employment-based pension, group health and other welfare benefit plans.

I appreciate the opportunity to testify before you today on H.R. 2269, the *"Retirement Security Advice Act of 2001."* At the outset, I want to commend you Mr. Chairman for scheduling this important hearing and thank Chairman Boehner for his commitment and leadership in seeking to ensure that working Americans have the advice they need to enable them to plan for a secure retirement.

The Department is very serious about its responsibility to protect plan assets from abuse. We believe the bill creates a strong, protective framework for the provision of investment advice to participants and look forward to working with you and all interested parties in achieving its important goal.

Meaningful comprehensive investment advice is more important now than it has ever been because of the increasing numbers of workers who have the responsibility for the investment of their pension plan assets. Their retirement security will depend, in large part, on how wisely they exercise this responsibility.

A recent (July 9, 2001) lead article in the New York Times, which discusses a report that documents recent losses suffered by 401(k) plans, also makes this point. The article cites financial planners and plan administrators in stating that "many people . . . put too much into a single aggressive mutual fund or their own company's stock." The article also cites a UCLA professor who states that "people are not doing a good job of picking portfolios." Clearly, these observations underscore the need participants have for high quality, professional investment advice. The work

of this Committee in seeking to solve this problem could not come at a more opportune time.

Secretary Chao has said that "to succeed in the 21st Century, our Nation must be prepared to adapt to changes in our economy. We cannot and must not simply react to changes. We must anticipate them, thus helping all workers to have as fulfilling and financially rewarding careers as they aspire to have." The Secretary believes we must apply this principle to preparing for retirement. The workforce of the 21st Century must have the opportunity for a fulfilling and financially secure retirement.

As part of the profound changes in the workplace, there have been profound changes in the design of the pension benefit plans that our mobile workforce prefers, generally giving workers more choice and responsibility for their retirement savings. When Congress enacted ERISA in 1974, employers used traditional defined benefit plans as the primary vehicle for providing pension benefits. As you know, under defined benefit plans, investment decisions generally are the responsibility of professional investment managers, and employees play no role in the selection or monitoring of plan investments.

Today, we estimate that over four fifths of all pension-covered workers -- an estimated 43 million workers -- are enrolled in defined contribution plans, either as a supplemental plan or their primary plan. A large majority of these plans are 401 (k) plans in which participants are responsible for directing the investment of their accounts among a number of choices provided by the plan. With 401(k) plans holding an estimated $1.7 trillion, and many providing more than 10 investment options from which to choose, the importance of providing participants with assistance in making informed and appropriate investment decisions cannot be overstated.

The increasing variety of factors outside the pension plan and the workplace that need to be considered when planning for retirement further emphasize the importance of enabling participants to effectively tailor their investment strategies to their individual circumstances. Many households have two wage earners and hold investments other than in their 401(k) plans. Formulating an appropriate course of action that takes into account other pension plans, savings outside pension plans, and ongoing financial obligations like college tuition, is an extremely complex endeavor, and increases the necessity for, and the value of, investment advice.

In 1974, the drafters of ERISA could not have anticipated these developments since 401(k) plans did not become widespread until the early 1980s. They created a legal framework that was consistent with the then-typical structure of employer created plans with assets managed by investment professionals who have a fiduciary responsibility to the plan. This structure does not translate well into advice relationships with individual participants.

Because the original statute did not contemplate the need for a means to provide investment advice efficiently to individuals, we support amendments to ERISA to accomplish this result. The sponsors of the *Retirement Security Advice Act* are to be commended for recognizing this need.

Need for Advice

Today's 401(k) type plan participant faces choices and challenges unknown to the participant of 20 years ago. Indeed, many are afforded the virtually unlimited opportunity to invest - through open brokerage accounts - in almost any security available in the marketplace.

It is no longer only financial professionals that need to know the principles of investment and asset allocation. Now that plan participants have been put in charge of investing the assets in their own accounts, they must be provided with the means for making appropriate decisions. These decisions will determine, to a great extent, the returns earned by their accounts, and, therefore, their security and standard of living during retirement.

Many employees simply are not sophisticated enough when it comes to risk/return strategies, asset allocation and other such investment tools. Further, many do not have the inclination, the time or the expertise to follow investment trends and market movements in today's fast paced global economy. As you know, today's workers lead busy lives, and many desire professional assistance with these critically important retirement decisions.

The Department sought to address this need by providing guidance in 1996 concerning the distinction between investment education and investment advice. The distinction being that investment advice gives rise to fiduciary responsibility under ERISA, while the provision of investment education does not. The 1996 interpretive bulletin provides guidance to investment advisers and employers showing how to provide educational investment information and analysis to participants without becoming a fiduciary under ERISA. However, in view of what is at stake, many 401(k) plan participants, even with investment education tools available, desire personally tailored advice. Investment education, while important, is simply not enough.

The cost of professional investment advice is, of course, a major deterrent. While some plan participants can and do engage their own financial advisers, the average participant is unlikely to be in a position to do so. Pension plans can generally purchase advice on more favorable economic terms than individuals, and plan sponsors can select advisors to provide the appropriate level and type of advice for their plan population.

Employer Liability

Most employers are not in the business of providing financial services. Yet they understand that the decision of whether and how to provide advice is a fiduciary action under ERISA. Therefore, it is reasonable to expect them to proceed with considerable caution.

Many employers express concerns regarding the appointment of an advisor for their

plan participants for fear of assuming fiduciary liability for the advisor's actual individual recommendations. Some have expressed the fear that their responsibility could extend to monitoring every recommendation given to every participant. Unless we satisfactorily address these and other employer issues, they will inevitably refrain from making advice available, regardless of any other steps we may take. The Department's 1996 guidance sought to allay these fears, but a conforming statutory amendment would serve to provide the certainty employers seek.

The Exemption Process

The exemption process enables the Department of Labor to provide relief from the application of ERISA's very broad prohibited transactions provisions. In order to grant an exemption, the Department must find that a transaction is in the interest of, and protective of, the participants and beneficiaries of the plan, after providing interested parties the opportunity to comment on a proposed exemption.

The exemption process comes into play in the advice area because ERISA prohibits fiduciary investment advisors from engaging in transactions with clients' plans where they have a conflict of interest. As a result, investment advisors cannot provide specific investment advice to 401(k) participants about their own firm's investment products without a prohibited transaction exemption from the Department.

Given the growing integration of the financial services industry, and the desire of many employers to deal with one provider for all 401(k) services, many advisors are in a position of having to come to the Department for a prohibited transaction exemption if they want to offer advice. In the past the Department has granted several exemptions in this area conditioned on fairly specific structural limitations. The requirements imposed have been criticized by some investment industry representatives as making little economic sense and as intrusive into the relationship between the advisor and the participant.

I am presently conducting a review of agency policy in this area, as well a review of the process, principles and philosophies that govern the process of obtaining an exemption. I believe that significant improvements are possible in this area without compromising the important protections afforded to plans and their participants. In all transactions, we need to develop a common sense approach that protects participants but is flexible enough to allow for competition and innovation. This review will be completed this fall.

I believe however, that the current situation of unaffiliated advisors with no need for exemption, some affiliated advisors with an exemption, and the rest prohibited from providing advice has created a situation that is disadvantageous to participants.

Advisors who have affiliations with investment products, and who seek an exemption from the Department also are at a competitive disadvantage. The time it

takes to receive an exemption and the conditions imposed by the Department have meant that affiliated providers often cannot be at the forefront of any market innovations, resulting in fewer choices available to participants and beneficiaries. I do not believe that individual prohibited transaction exemptions are the best way of addressing this problem.

H.R. 2269, the "Retirement Security Advice Act of 2001"

The Retirement Security Advice Act recognizes that, in many cases, the plan will be a participant's only source of investment advice. The bill would afford average plan participants access to "fiduciary advisers" who are regulated by Federal or state authorities. It would provide extensive information to participants about fees, relationships that may give rise to conflicts of interests, and limitations on the scope of advice to be provided. We believe these and other protections in the bill create a basic framework for assuring that advice is fairly provided and would welcome the opportunity to work with the Committee to ensure that these protections are adequate.

The bill also recognizes that employers are understandably concerned about their roles in selecting and monitoring investment advisers for their plan participants. The bill specifically defines the scope of the fiduciary review function to be undertaken by the employer in this regard. It clarifies that such duties do not extend to monitoring the specific advice given by the fiduciary adviser to any particular participant. We believe such clarification will lead to the broader availability of participant investment advice.

Legislation like the Advice bill will bring flexibility to the area by setting forth rules for all affiliated investment advisors. The Advice bill will also place affiliated advisors on a more equal competitive footing with non-affiliated advisors, will foster competition among firms, and promote lower costs to participants.

Conclusion

We fully support your efforts to deal with this important issue and seek the same objectives as those proposed by your bill - strong protections and certainty for participants, employers and service providers, a level playing field, greater choice among advisers and the expansion of needed investment advice for participants and beneficiaries in 401(k) type plans. We would like to work with you further on other aspects of the bill that go beyond the provision of investment advice to participants and beneficiaries. Once again, we commend the Committee for its leadership and we look forward to working with you and your staff on this important legislation.

Thank you again, Mr. Chairman, for the opportunity to present our views on this important legislation. I will be pleased to answer any questions you or any members of the Subcommittee may have.

APPENDIX D - SUBMITTED FOR THE RECORD, LETTER TO CHAIRMAN WILLIAM GOODLING, COMMITTEE ON EDUCATION AND THE WORKFORCE, U.S. HOUSE OF REPRESENTATIVES, FROM ALEXIS HERMAN, SECRETARY OF LABOR, U.S. DEPARTMENT OF LABOR, JULY 19, 2000

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SECRETARY OF LABOR
WASHINGTON

JUL 19 2000

The Honorable William F. Goodling
Chairman
Committee on Education and the Workforce
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Goodling:

We understand that your Committee may consider H.R. 4747, the "Retirement Security Advice Act of 2000", H.R. 4749, the "ERISA Modernization Act"; and H.R. 4748, the "Comprehensive ERISA Modernization Act of 2000", which substantially includes the provisions of both H.R. 4747 and H.R. 4749. Although these bills aim to "modernize" the Employee Retirement Income Security Act of 1974 ("ERISA") and "empower" workers with more information to improve their retirement security, in fact, they could remove key protections in ERISA. Department of Labor staff attempted to work with Committee staff in a bipartisan manner on these issues and we regret that the sponsors decided to proceed with introducing these bills. The Department of Labor strongly opposes the bills.

As stated in testimony before your Subcommittee, we believe that the core fiduciary standards, including the prohibited transaction rules, have served American workers and their beneficiaries well and should not be altered without ensuring that other protections are in place. The phenomenal growth in 401(k) plans clearly demonstrates the confidence workers and employers have in the integrity of our Nation's private pension system.

With the many participant-directed retirement savings accounts and the complexity of investment alternatives, we recognize both that many participants need unbiased investment advice and that many employers would like to help provide that advice. Still, we want to ensure that needed protections are in place. Also, as detailed in the enclosure to this letter, we strongly oppose the provision that would eliminate current protections applicable to investments offered by affiliates of the fiduciary advisor.

We also recognize that certain aspects of the process for receiving prohibited transaction exemptions should be streamlined. For example, we believe that providing the Department with appropriate authority to issue interim exemptions and/or to issue exemptions, in certain instances, without

publishing a proposed exemption in the *Federal Register* would be beneficial. We will also explore how to accelerate the handling of exemption requests without losing essential protections. Such changes could permit the exemption process to proceed more expeditiously, yet continue to provide necessary protections for workers' retirement benefits.

Furthermore, the Department recognizes that many participants in 401(k) plans need investment education and may need investment advice. Interpretive Bulletin 96-1 was issued to clarify the difference between education and advice and encourage plan sponsors to provide educational materials. The Department is working with members of the regulated community to find out how we can do more to ensure that participants and beneficiaries are given informed, unbiased, and adequate guidance in investing their plan accounts.

In conclusion, we must be mindful of the fact that the continued vitality of our private pension system is based on the confidence of workers and plan sponsors in the system's integrity. Any legislative change must respect the need for ERISA's fundamental protections. Consequently, the Department strongly opposes these bills in their current form.

The Office of Management and Budget advises that there is no objection to the submission of this letter from the standpoint of the Administration's program.

Sincerely,

Alexis M. Herman

Enclosure

cc: The Honorable William Clay

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ENCLOSURE

"Retirement Security Advice Act" (H.R. 4747)

No one disputes the need for providing more investment advice to workers in self-directed retirement plans. However, the "Retirement Security Advice Act" would effectively leave retirement plan participants and beneficiaries vulnerable to bad and, in some cases, conflicted investment advice with little or no meaningful recourse if they rely on it. The bill would create a statutory exemption from the prohibited transaction rules for "fiduciary advisers" who provide investment advice to a plan, or to its participants or beneficiaries. Such advisers would be required to disclose their fee arrangements and interest in any assets they recommend for purchase or sale (along with other required disclosures); in return, they could not be held liable under ERISA's *per se* prohibitions for the advice they render. Indeed, as drafted, the bill would create an exemption for investment advice provided to all plans, not just to participants in individual account arrangements.

Under this bill, advisers may not be subject to state law remedies for the advice they provide to plans or participants. At the same time, the bill would severely limit their fiduciary duty not to engage in transactions where they have a potential conflict of interest. Participants harmed by the advice would have to show that the advice was imprudent, a much more difficult task than showing a conflict of interest. This alteration of the rights and remedies that currently govern the provision of investment advice would place the risk of bad investment advice squarely on the participant.

Further, the information disclosed under the bill would not, in and of itself, allow an unsophisticated investor to make a determination as to whether the advice being provided is "tainted" by conflict or self-interest. In certain instances, this bill would place the participant in the untenable position of having only confected advice to guide them.

Perhaps the most troubling aspect of the investment advice provisions in the bill is that they would eliminate current protections applicable to certain plan investments in securities or other property issued or sold by affiliates of the fiduciary adviser. The existing statutory exemptions currently apply to "routine" transactions with related parties. However, the bill would allow plan fiduciaries to cause a plan to engage in non-routine as well as routine investments, even transactions with the fiduciaries themselves, simply by obtaining "advice" to do so from a fiduciary adviser. Such a broad exemption raises the

potential for serious abuse of the self-dealing and conflict of interest provisions of ERISA.

Further, the only disclosures which would be required under this bill are those necessary to comply with securities laws. This ignores any requirements for disclosure for all other types of investments.

"ERISA Modernization Act" (H.R. 4749)

The "ERISA Modernization Act" would cripple the prohibited transaction rules which prevent abuse of pension and health assets by certain persons. At the time ERISA was drafted, there was considerable debate concerning whether the prohibited transaction rules should act as an outright bar, or whether these transactions should be barred only if a plan did not receive adequate consideration. Ultimately, the adoption of an outright bar was regarded as "having closed what otherwise would have been a major loophole in the Federal effort to protect the integrity of employee pension and welfare funds against 'raiding' by insiders."[1] The bills would effectively establish a loophole which is similar to that which was rejected at the time ERISA was originally passed.

The protections that these rules provide for the retirement and health benefits of American workers are at least as relevant today as they were at the time ERISA was enacted. Prior to ERISA, plans had been abused, in part, because those who profited from dealing with plans were typically more sophisticated than persons who acted on behalf of pension and health plans. Since ERISA was enacted, the financial markets and transactions have grown so complex that in many cases only the professionals who developed the particular product or service are able to effectively understand and evaluate the attendant risks. The resulting gap in experience and sophistication between persons who act on behalf of a plan, such as plan sponsors, and service providers to a plan is probably greater today than it was at the time ERISA was enacted. Further, the consolidation in the financial services industry has increased the incentive and opportunity for overreaching because the financial services providers often are affiliated with the sellers of the investment products they market. Therefore, the prohibited transaction rules are more important to the integrity of plan funds than they were in 1974.

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[1] See Legislative History of the Employee Retirement Income Security Act of 1974, 120 Cong. Rec. 29940 (1974) (Statement of Senator Javits).

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The bill would effectively substitute disclosure in place of the substantive protections of the prohibited transaction rules. This risks harming workers' retirement benefits in several significant ways.

First, the change would weaken or eliminate rules designed to prevent the abuse of benefit plans by persons who profit from their dealing with plan funds. This would shift responsibility from persons who are in the business of offering such products and services and are most knowledgeable about the market to persons who hire and monitor such persons, usually plan sponsors, who typically know far less. We believe that such a shift would lead to abusive arrangements. This would also increase the responsibility of plan sponsors because they would now be dealing with persons who are subject to a less protective regulatory framework. The increased responsibility could discourage plan sponsors, who are sensitive to increased potential liability and regulatory burdens, from establishing and continuing to maintain employee benefit plans.

Second, disclosure is only meaningful if the recipient can understand and check the accuracy of the disclosure. In many cases, the recipient will have no ability to do either, or could only understand or check the information by hiring a competent professional at additional expense. For these reasons, we believe that this disclosure cannot and should not substitute for the protection that American workers' retirement and health funds receive under ERISA's prohibited transaction provisions.

Finally, the bill would eliminate the protections provided by ERISA when pension and/or welfare plans purchase units or other interests, together with other plans, in vehicles that essentially provide investment management services. Under the bill, if a promoter markets such a vehicle as particularly appropriate for plans, and the promoter raises 100% of the money it manages from plans, the money managed by the promoter would generally not be protected by ERISA. The removal of such protections provided by ERISA, which are generally applicable when any person manages funds for plans, would lead to overreaching and abuse of funds set aside to provide retirement and health benefits to American workers.

APPENDIX E - WRITTEN STATEMENT OF BETTY SHEPARD, HUMAN RESOURCES ADMINISTRATOR, MOHAWK INDUSTRIES, INC., KENNESAW, GA

Testimony of Betty Shepard

Human Resources Administrator, Mohawk Industries, Inc.

Before the Subcommittee on Employer-Employee Relations

July 17, 2001

Good Morning. Chairman Johnson, Ranking Member Andrews, I thank you for the opportunity to comment on HR 2269, the Retirement Security Advice Act and the importance of enhancing the law to enable plan sponsors to provide professional investment advice to plan employees. My name is Betty Shepard and I serve as the Human Resources Administrator for Mohawk Industries, Inc. Mohawk Industries is the second largest carpet manufacturer in the world with its headquarters in Calhoun, Georgia. We currently employ approximately 25,000 people; 90% of which are hourly production workers. Included in our employee base is aare a large number of Spanish speaking employees. Because of our employee demographics, providing information and education on plan rules and investments has been challenging and often unsatisfactory.

We feel our benefits programs are amongst the most competitive in the industry. In particular, we are very proud of the retirement plan that we make available to our employees. We are the Plan Sponsor for the Mohawk Carpet Corporation Retirement Savings Plan (the "Plan") which offers employee pre-tax, employer matching and profit sharing features. Our Plan has assets of approximately $223 million, representing the accounts of over 21,000 employees. The Plan offers 11 investment options in all major asset classes including Stable Value, Bonds, Balanced Funds, Large & Small Cap Funds, International Funds and Mohawk Company Stock. Our annual Profit Sharing contribution is made in Mohawk Stock and can be directed by the employee into any other investment option in the Plan.

Mohawk utilizes the services of a bundled record keeper to handle the daily administration of our Plan. The record keeper has a department dedicated to helping us educate our employees about the Plan. We work extensively with them to promote education relative to participation, retirement planning, asset allocation and diversification. In fact, the education materials that were developed for our employees won industry awards for its content and the presentation of information on the Plan parameters and investing basics. Despite our significant efforts to provide the necessary tools for employees to make investment decisions, they continue to look to us to provide specific investment advice. Due to the substantial fiduciary liability associated with the delivery of specific advice under current law, we do not offer access to advice on investment choices to our employees. While Internet based services can assist many plan sponsors, we do not feel that this will adequately address our employees' needs, as the majority do not have access to the

Internet at home or work.

Currently, the assets of our Plan are invested by employees as follows:

36% - Stable Value

2% - Bonds

7% - Balanced Funds

41% - Stock Funds

9% - Company Stock

5% - Participant Loans

As you can see from our plan's asset allocation, our employees invest predominately in either Stable Value funds that may not keep up with inflation or they are heavily weighted in stocks which have a greater risk of the loss of principal. We continue to provide education in the form of face-to-face meetings and mailings to employee's homes but this is not meeting employee needs and does not satisfy their questions and concerns.

I come before you today in support of the Retirement Security Advice Act and ask that you and your colleagues pass this very important law so that we can provide our employees with the professional investment advice that they need to make good, sound investment decisions. Without this assistance, I fear that many of our employees may overreact to market fluctuations and listen to the commentary of family, friends or the media (who are not investment professionals) to make retirement planning decisions. This unprofessional advice could lead to many employees having smaller nest eggs than they will need to live comfortably in retirement.

Some critics opposing this bill have stated that changes to ERISA would reduce the fiduciary obligations of Plan Sponsors or that conflicts of interest could arise with financial service providers. Our fiduciary obligations do not disappear with this bill. Plan Sponsors, such as Mohawk, will remain responsible for the selection and monitoring of the individuals that we entrust with delivering unbiased advice to employees.

In closing, I want to thank you again for this opportunity to testify and stress that our employees need assistance in directing their investments. We commend Chairman Boehner for introducing this very important bill that would enable us to provide our employees with the information they need to save wisely towards their retirement. I am pleased to answer any questions you may have.

APPENDIX F - WRITTEN STATEMENT OF DAMON SILVERS, ASSOCIATE GENERAL COUNSEL, AFL-CIO, WASHINGTON, D.C.

Testimony of Damon A. Silvers

Associate General Counsel, American Federation of Labor and Congress of Industrial Organizations

Before the Employer-Employee Relations Subcommittee

July 17, 2001

Good morning Mr. Chairman. My name is Damon Silvers, and I am an Associate General Counsel of the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO). On behalf of our member unions, their 13 million members and more than 2 million retirees, I would like to thank you, Mr. Chairman, and this subcommittee for the opportunity to testify on the important question of how to improve the information available to workers and retirees who participate in 401(k) plans and other self-directed retirement plans.

The AFL-CIO is strongly in favor of ensuring that participants in 401(k) plans and other self-directed plans receive the best possible advice on how to invest their retirement money. We have heard several concerns raised about the way ERISA currently regulates investment advice.

Employers and plan administrators have come before the Department of Labor and this subcommittee and expressed concern that there is legal uncertainty as to whether: (1) ERISA plan assets may be spent to obtain investment advice for plan participants; and (2) whether employers are liable to their employees and retirees for the specific recommendations made by investment advisors. This continued uncertainty may well be a real obstacle to significant numbers of workers and retirees having access to investment advice. In our view, all such uncertainty should be removed so that ERISA plans are able, without hesitation, to provide both investor education and individualized investment advice for their participants; and employers are confident that if they provide investment advice from an outside independent outside firm, and do so under the general standards set forth by ERISA for retaining service providers, they will not be held liable for the specific advice given to plan participants.

We, thus, support codifying the Department of Labor's Interpretative Bulletin 96-1 that ERISA neither limits plan expenditures on investment advice nor makes employers liable for the particulars of the advice given investment advice for their plan participants.

Unfortunately, H.R. 2269, the bill that is the subject of today's hearing, ties this needed reform to an ill-conceived and narrowly self-interested effort by the

investment management industry to weaken ERISA's safeguards against conflicts of interest in investment advice. H.R. 2269 would allow benefit plans to contract with one firm to both manage participants' investment funds and to provide those same plan participants with personalized investment advice. That is, advocates of diminishing ERISA's current worker protections have sought to link their agenda of promoting conflicted advice to the question of limiting employer liability. But these two issues are completely separate and should be evaluated on their separate merits.

The question of whether to amend ERISA to allow conflicted investment advice is inseparable from the question of the effectiveness of the Investment Advisers Act and the Investment Company Act in protecting investors against conflicted advice. Last month, the House Banking Subcommittee on Capital Markets held hearings on the impact of conflicted investment analysts at the major financial services firms – many of which are clamoring to be allowed to provide conflicted investment advice. At this hearing, members from both sides of the aisle, led by Chairman Baker, expressed concern that the pure disclosure regime of the securities laws was allowing financial service firms systematically to steer individual investors towards stocks in companies with which the financial service firms had underwriting relationships, even when those stocks were poor investments. The financial services industry's response was largely that investors should have known that they were receiving tainted advice and not been so ready to make investment decisions based on their analysts' recommendations. (I have attached a copy of AFL-CIO's testimony at that hearing.)

In light of the manifest failures of this disclosure regime to adequately protect individual investors in the securities markets, it is richly ironic to suggest that Congress should now dismantle the substantive protections in the area of investment advice on which defined contribution pension plan participants now depend favor of an alternative model that appears to be in crisis.

It is helpful in understanding why conflicted investment advice is harmful to plan participants to review briefly what "investment advice" is in the context of defined contribution retirement plans. "Investment advice" consists of personalized recommendations given to individual ERISA plan participants directing them to exactly which investment options they should choose among those available to them in the plan. This type of personalized advice, typically, is given to plan participants through computer programs accessed via the Internet. The formulas that are the heart of the provision of investment advice are proprietary. While some independent investment advisors have disclosed their methodology, to our knowledge, no firm seeking to provide conflicted advice has done and H.R. 2269 will not require them to do so.

"Advice" is distinct from "investor education" in which participants are given general financial and investment information, such as how to think about asset allocation over a lifetime.

Access to investment advice, typically, is provided to plan participants at no

apparent cost. In fact, however, advice is not free. Rather, the cost is built into the overall fee structure of the 401(k) plan, which includes general administrative fees and fees that are specific to the plan's various investment options.

All of these factors make it very difficult for plan sponsors or plan participants to come to any conclusion about whether a particular investment advice program is objective or not. We do not believe that most union-sponsored pension plans or small employer plans either are cost-effective monitors or have the market power to demand that the financial service firms change practices to address these concerns.

One of the peculiar things about the investment advice debate is that currently most major financial service companies offer independent investment advice, including industry leaders like Vanguard, Merrill Lynch, and Frank Russell. Most do so through contractual arrangements with independent firms like Financial Engines, Morningstar, mPower and Standard & Poors. In addition, some major financial institutions have sought and obtained waivers of the prohibited transaction rule from the Department of Labor, and themselves offer investment advice directly to plan participants. Finally, any money management firm that wishes to offer investment advice to 401(k) plans is free to do so; it simply cannot do so to a plan where it is already offering investment management services. The result is that, according to a Deloitte & Touche LLP survey earlier this year, 60% of plan sponsors are offering investment advice to their participants. I have attached an article from Pensions & Investments summarizing that study, together with a table prepared by mPower, an independent advice provider, showing that two thirds of financial services providers with more than half a million participants in self-directed retirement plans currently are offering these participants independent advice.

This data suggests that the real issue the money management firms have with the current state of investment advice is that they are not allowed to sell investment advice to 401(k) plans where: (1) they have a competitive advantage because of their role as plan administrator and are likely to be able to exclude independent advisors; and (2) they can profit from influencing plan participants' investment choices. It is not that they want to sell advice; they can do that now. It is that these large firms want to sell conflicted advice.

Their position begins to make sense if one considers the economics of 401(k) plan money management. The investment management fees (the expense ratios) of different mutual funds vary from a few hundredths of a percent per year of a worker's account for a low risk money market fund to more than 1% per year of a worker's account for a higher risk actively managed equity fund, e.g. a growth fund or emerging market fund. Generally, fees for money market funds are lower than fees for bond funds, which are lower than fees for stock funds. Indexed or passively managed stock funds have dramatically lower fees than actively managed funds. Generally, the higher the fee to the worker, the higher the margin for the money manager.

The amounts of money involved here potentially are quite large. For example, the difference in expense ratios between a typical indexed large-cap equity mutual fund and a typical actively managed equity mutual fund is around 1%. If, as a result of self-interested investment advice, a worker ended up paying just 1% more for money management services per year than he/she would have otherwise, the size of that worker's 401(k) account at the end of a forty year career would be approximately 26% less than it otherwise would have been. And the temptation from the industry's perspective may be irresistible since a similar increase in money management fees by just one tenth of one percent across the current assets held in American workers' 401(k) accounts would generate $18 billion annual incremental revenues -- a large portion of which, we believe, would go straight to money management firms' bottom lines.

Workers not only risk being steered toward high fee investment products. They also face the risk of what might be called "point shaving" in the area of asset allocation. We do not believe any firm will systematically advise plan participants to engage in grossly inappropriate asset allocation for self-interested reasons. However, because investment management is a famously inexact art, there is plenty of room to shade recommendations by 5 or 10% in the direction of higher fee asset classes -- particularly equity funds.

We know from the recent data published in the New York Times on declining 401 (k) account balances that retirement assets in 401(k) plans already are tilted too far in the direction of equities. If this bill were to pass, there would be every incentive for money managers to subtly worsen this problem through their provision of investment advice. And there would be no way to prove that a given money manager did not in good faith believe that a worker in his/her forties should have 65% in equities, rather than 60%. Self-interested investment advice models that encourage workers to over-invest in equities and to do so through higher-fee mutual funds could easily result in the transfer of tens of billions of dollars of workers' retirement savings into the hands of money management firms, as well as in encouraging workers to overweight their portfolios in equities, leading to sub-optimal risk exposure.

It is no wonder then that, in the last few months, financial journalists in publications as diverse as the Time, the New York Post and Plan Sponsor and Pensions & Investments have labeled conflicted investment advice a threat to plan participants. As the Department of Labor stated in its July 19, 2000 letter to then-Chairman Goodling, "the 'Retirement Security Investment Act' would effectively leave retirement plan participants and beneficiaries vulnerable to bad and, in some cases, conflicted investment advice with little or no meaningful recourse if they rely on it." That letter is attached to this testimony.

In response to these concerns, H.R. 2269 offers little more than disclosure of any conflicts. And, according to bill proponents, workers and retirees can then decide whether to take the advice or not. After all, isn't this how our securities markets generally work? There is one huge difference, however, between the world of

retirement plans and the world of securities regulation. In the area of retirement plan investment advice, workers and retirees simply don't have meaningful choice as to whether to spend their retirement assets on conflicted advice, whereas in the securities markets, generally, customers can change investment advisors freely.

This is because, even now, the 66% of plan participants who have access to investment advice through their 401(k) plans do so through a single independent investment advice provider. The fee for that advice is built into the general administrative fee charged to plan participants. Thus, workers or retirees who decide they want other advice will have to pay twice -- once through their 401(k) plan's fee structure and another time with after tax dollars in the open market when they go to buy advice they trust.

Consequently, even if it were possible to design a disclosure requirement that truly would inform plan participants whether the advice they were getting is biased or not, to act on that disclosure would require a plan participant to pay twice for investment advice.

In summary, there is no crisis in the provision of investment advice that requires the solution of allowing conflicted investment advice. On the contrary, given the prevalence of independent advice firms, there is real reason to believe that financial services firms' desire to get into the business themselves is self-interested, and it is easy to understand what source of that self-interest -- the possibility of literally shifting billions of dollars from workers' retirement accounts to their own firms. There is also no reason to think disclosure can substitute here for the ban on conflicted advice. ERISA funds do not give participants the range of choices to allow them to act on what they know, and even in the securities arena, disclosure has proven to be a poor remedy for conflicts of interest on the part of money managers.

This subcommittee should be inquiring as to why some 401(k) plan sponsors continue to fail to provide advice to their participants, and considering a balanced remedy for this real problem. But it will be acting in the interests of pension beneficiaries only if, at the same time, the subcommittee ensures the integrity of ERISA that has protected workers and retirees from self-dealing in the myriad places where it can appear. The AFL-CIO is ready to assist the subcommittee on this matter, and thanks the subcommittee for inviting us to appear today.

APPENDIX G - WRITTEN STATEMENT OF RICHARD A. HILLER, VICE PRESIDENT, WESTERN DIVISION, TIAA-CREF, WASHINGTON, D.C.

Testimony of Richard A. Hiller
Vice President, Western Division
TIAA-CREF

Before
The House Committee on Education and the Workforce
Subcommittee on Employer-Employee Relations
Representative Sam Johnson, Chairman
on
The Retirement Security Advice Act of 2001 (HR.2269)
and
The Employee Retirement Income Security Act of 1974 (ERISA)

July 17, 2001

Introduction

Good morning, Chairman Johnson, Representative Andrews and Members of the Committee. I am Richard Hiller, Vice President, Western Division of the Retirement Services area of the TIAA-CREF Group, which specializes in managing and administering defined contribution retirement savings plans for over 10,000 primarily educational and other not-for-profit organizations. Most of our two million participants are covered by pension and tax-deferred annuity plans that operate under Section 403(b) of the Internal Revenue Code. Today, TIAA-CREF makes retirement income payments to about a half a million retirees. Our organization manages over $260 billion in assets.

For over 80 years, TIAA-CREF has worked closely with the higher education community to provide an adequate retirement income to educators and staff. As a result of our joint efforts, 95% of the full-time employees in higher education are eligible to participate in a retirement plan - either a defined contribution plan or a state retirement system. The American Association of University Professors, the American Council on Education, the College and University Professional Association for Human Resources and the National Association of College and University Business Officers join in support of our statement.

We are pleased to share our expertise with the committee as it explores adopting changes to ERISA in the context of the current retirement savings environment and to support the Retirement Security Advice Act of 2001 (HR.2269). During the series of hearings that led up to the enactment of the Employee Retirement Income Security Act of 1974 (ERISA), Senator Jacob Javits cited TIAA-CREF as a pension role model. This esteemed co-author of ERISA might be surprised to see how employers and employees have embraced the defined contribution pension model. Today, over 40 million workers are covered by defined contribution plans with total

assets in defined contribution plans equaling $2.45 trillion dollars in 1999, of which $1.9 trillion is in 401(k) plans.

Of course, pension choices were much more straightforward years ago. Defined benefit plans were the corporate retirement model and 401(k) plans did not exist. Performance of the stock market in the mid 70's made it a scary place for the unsophisticated investor. At that time, we offered participants a choice between TIAA, a traditional fixed annuity and CREF, a variable annuity invested in stocks. Most of our participants found the best way to hedge their bets was to use a 50/50 allocation split between the two choices, but the public at large was a long way from embracing mutual funds and, in particular, equities.

Times change - and so have the needs and expectations of not only TIAA-CREF participants but also all workers covered by pensions and 401(k) plans. As a result, TIAA-CREF responded by offering an enhanced range of investment choices and greater income options. This has considerably complicated the decision-making process for our participants - and they are not alone. According to Hewitt Associates, the average participant in a 401(k) plan had eleven investment choices. Moreover, most 401(k) plans aren't structured to provide lifetime payout options in retirement and retirees often find that they are on their own to decide how to make their money last throughout retirement.

Providing Financial Education

While greater choices have challenged employees making financial decisions, many workers have at the same time become more sophisticated about investing. The questions TIAA-CREF and the employers we work with most frequently hear are: "How should I allocate my retirement contributions?" "Will I have enough when I want to retire?" and "How should I take my retirement income - as an annuity or lump sum?" TIAA-CREF believes that by providing participants with educational resources and information, we can help them make the right financial decisions about saving and investing. Our founding charter, written in 1918, established financial education as an important mission for TIAA-CREF and over the last decades we have greatly expanded our efforts to help our participants answer the above questions.

Today we use a variety of tools, techniques and media to carry out our financial education mission. Our publications include one-page stuffers, single topic pamphlets, newsletters for participants and plan administrators and special reports covering key issues. TIAA-CREF materials cover topics including investment options, calculations of retirement income needs, and explanations of various tax issues, such as the recent tax bill which created greater retirement savings incentives. These educational efforts are supported by group seminars, which TIAA-CREF offers in partnership with employers customized to their plan as well as other seminars like our Financial Education Series (FES), and individual counseling by registered representatives in our phone centers or through face-to-face meetings. In addition, TIAA-CREF uses internet technology to deliver

information and service.

To help participants apply financial education to their own situations, TIAA-CREF has developed principles that underlie our guidance. For example, we recommend that participants diversify their retirement accounts among equities and at least two other asset classes and emphasize that diversification remains important after retirement. When participants reach retirement, we remind them that they should plan to live beyond their life expectancies and we discuss how a lifetime annuity can play a role in ensuring an adequate income for life. For the most part, general education and guidance helps participants to make their decisions. In fact, a survey by Roper Starch determined that 75% of attendees at our FES programs were "very satisfied" with the program and half of all respondents indicated that they had changed, or planned to change, their financial behavior. But, participants want more; they want advice.

The more education and guidance available to an individual, the more he or she is likely to benefit from it. In a 1997 study of TIAA-CREF participants and their investment strategies, economists Professor Bodie and Professor Crane wrote: ". . . our findings suggest that, given enough education, information and experience, people will tend to manage their self-directed investment accounts in an appropriate manner."

As workers seek help in making their investment decisions, investment advice is the obvious next step in the financial education spectrum. In a recent American Council of Life Insurers (ACLI) survey of 401(k) participants, 74% believe that it is in the best interest of workers to have as much information as possible on investing their retirement savings and feel that workers do not get enough guidance from the current system. A similar survey of TIAA-CREF participants found that nearly 70% are interested in obtaining personal recommendations on how to allocate their retirement savings. Another TIAA-CREF survey of participants revealed that 75% wanted advice on retirement income options with an even greater response (84%) among participants in the pre-retirement ages.

Participant Reactions and Need for Greater Assistance

Choosing the right investments for a retirement portfolio is a critical decision for our participants. Over time, the basic financial education we provide participants evolved into general "models" designed to fit general time horizons and risk tolerance parameters, as permitted by the Interpretive Bulletin issued by the Department of Labor. Today, one of the ways we offer guidance and education is with an interactive calculator that considers not only risk tolerance and time horizons but also goals and investment preferences.

We recently studied the impact of our asset allocation guidance on our participants' decision-making process and subsequent actions. The study compared the asset allocation decisions of TIAA-CREF participants who received an asset allocation guidance through our software with "control" groups of other TIAA-CREF

participants. This analysis indicated that almost two thirds of the group that received asset allocation guidance changed their investment mix and they were much more likely to begin using new, recommended investment accounts than were members of the control groups. It is important to stress that allocation guidance is voluntary and that the majority of participants did not follow the software's allocation recommendation "to the letter."

This experience shows that participants seeking out retirement savings advice, evaluate the recommendations and then make adjustments to fit their personal comfort level. Personalized advice is a further enhancement that can enable participants to sort through their complex choices. The preliminary results of a TIAA-CREF Institute-sponsored survey that was just conducted provide further insight on this matter. 86% of the respondents expressed a preference for using a financial advisor who provides quality information rather than one who assumes control over their investment options. Thus, we believe that receiving retirement advice that is personalized to the individual's situation would allow him/her to make more informed decisions without compromising their control.

Providing retirement advice should have a positive impact on employees' retirement savings activity. The pension provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 enhance the retirement savings opportunities for millions of American workers. But, according to an economic analysis of financial planning and its associated costs by Professor Lusardi, many workers may not take enough time to plan for these new retirement savings options. She found that households not planning for retirement end up having much lower savings than households that have thought a lot about retirement. Evidence from this empirical work suggests that programs that provide investment advice as well as information on saving can give individuals an incentive to start saving, especially among women and low-income workers.

HR.2269 addresses the challenge posed by ERISA

Currently, under ERISA, pension plan service providers like TIAA-CREF and employers are significantly constrained from providing individualized investment advice to workers in the plans they service. Although education and guidance as allowed under the Interpretive Bulletin are helpful, many participants want and need more. And while it is possible for a service provider to provide specific investment advice to plan participants, it requires reliance on prohibited transaction exemptions that either the DOL has called into question for this purpose, or else impose onerous restrictions. Moreover, the current guidance, including the Interpretive Bulletin, does not specifically address advice related to the choice of retirement plan payout options.

Consequently, some employers who are willing to help those employees who want customized advice must hire a third party. Wealthier Americans have been able to hire their own investment advisors as necessary, while most middle income families do not. As a result, most employees have been "on their own" in terms of making

essential and life affecting investment decisions.

The Retirement Security Advice Act introduced by Chairman John Boehner would allow employers subject to ERISA to provide their employees with access to professional investment advice from a financial institution that is a service provider to the plan.

TIAA-CREF supports this bill because we believe it will provide employees with much needed investment advice in an increasingly complex retirement planning environment. At the same time, it affords substantial protections to employees. While the bill allows "fiduciary advisors" an exemption from the restrictions of ERISA section 406, the advisor is an ERISA fiduciary and is subject to the requirement to act solely in the interest of participants and beneficiaries. If its advice is imprudent, the advisor would be subject to fiduciary liability. The bill also requires investment service firms that provide investment advice to employees in the plans they service to fully disclose all relevant information about the advisor's fees and potential conflicts. The participant can choose whether to accept or reject the advice provided.

While remaining responsible as a fiduciary for the selection of the financial advisor and periodically monitoring its performance, the employer would not be responsible for the actual investment advice recommendations. This provides the employer with a significant comfort level to permit a service provider to give advice to plan participants.

At TIAA-CREF, we believe that HR.2269 will be a great advantage for those individuals who are seeking investment advice to be able to receive it from their retirement plan's financial service provider. Trust of participants is a crucial dimension of their relationship with a financial services firm. The responsibilities of a "fiduciary advisor" are standards that we, at TIAA-CREF, operate under already. Under HR.2269, this high standard will be imposed on any financial advisor that wants to provide investment advice to retirement plan participants.

APPENDIX H - WRITTEN STATEMENT OF JOSEPH PERKINS, IMMEDIATE PAST PRESIDENT, AARP, WASHINGTON, D.C.

Testimony of Mr. Joseph Perkins

Immediate Past President, AARP

Before the Subcommittee on Employer-Employee Relations

July 17, 2001

AARP appreciates the opportunity to present our views on the Retirement Security Advice Act (H.R. 2269) and the emerging issue of investment advice for individual account plan participants. While there has been an explosion in the number of individual account plans over the past two decades, many -- if not most -- participants still lack knowledge of basic investment fundamentals. As a result, AARP shares the goal of increasing access to investment advice for pension plan participants. The need for such advice is not only necessary, but also inevitable. However, in providing specific guidance to plan participants, AARP believes that we should continue to adhere to ERISA's long-standing protections for plan participants. As a result, AARP believes it would not be consistent with ERISA, nor in the best interests of plan participants, to encourage plans to provide advice subject to inherent financial conflicts.

In the traditional defined benefit plan, the employer invests all plan assets, with benefits guaranteed to participants. However, in 401(k) and other individually directed account plans, the individual controls the investment allocation, and the participant must invest well in order to ensure an adequate level of retirement benefits. Unfortunately, many individuals are simply not prepared to handle this investment responsibility and risk.

Most participants have little experience in, or understanding of, investment fundamentals. While almost half of all households now have some money in equities or mutual funds – up over 50 percent in the past decade – many of these are new investors. In addition, many have no other investments aside from their retirement plan. This is particularly true for those households below the median income, who are far less likely to have any money in an equity fund. Even for those who have entered the investment marketplace, too few have the time, or have taken the time, to learn the basics of investing.

A recent survey conducted for AARP ("Consumer Behavior, Experience and Attitudes: A Comparison By Age Groups," conducted by Princeton Survey Research Associates, March 1999) sought to provide a snapshot of the public's basic investment knowledge by asking four questions:

Whether the FDIC covers losses from mutual funds

purchased at banks,

Whether no-load mutual funds involve sales charges or other fees,

Whether diversification increases or decreases the risk of the investments, and

Whether full-service brokers and financial planners are compensated on the quality of their advice or on the amount and type of investments they sell to clients?

The unfortunate findings are that not many Americans are knowledgeable about financial investments. Only 11 percent of respondents answered all questions correctly, while only 25 percent correctly answered three of four and less than half (46 percent) answered two questions correctly. Just over one-third could correctly answer whether diversification reduces risk.

Investment knowledge is only part of the story. Individual investors (particularly lower-income persons and women) also tend to be more conservative investors, with less risk tolerance than professional fund managers. Individuals also have smaller portfolios, which may be harder to diversify and may face proportionately larger fees as a percentage of their holdings.

Lack of information is also not the problem; the amount of financial information available today is greater than ever before. Magazines, newspapers, daily financial news programs, on-line services, and various types of software make available more information than most individuals could want or need. In addition, the plan itself often makes available many different forms of information, including videos, seminars and booklets on plan options and hypothetical investment portfolios. What the individual investor needs, however, is the ability to sort through the information. As noted, too many investors or would-be investors lack both the time and the knowledge to determine which information is important, accurate and appropriate for their own individual situation. These issues are especially true in the case of self-directed plans.

The Department of Labor, through Interpretive Bulletin 96-1, provided a helpful step by encouraging greater investment education for plan participants. The guidance provides examples of "safe harbors" that do not rise to the level of specific advice and thus do not trigger fiduciary liability under ERISA. Under the safe harbor, a plan may currently make available information and materials that provide participants with asset allocation models based on hypothetical individuals with different time horizons and risk profiles. The plan must ensure that the models are based on generally accepted investment theories, must provide all material facts and assumptions on which the models are based, and must inform individuals that they should also consider other assets outside the plan. The asset allocation model may also identify specific investment alternatives under the plan, but to the extent it does

so, the information must inform the participant that other similar investment alternatives are available under the plan and identify where information on those alternatives may be found. These asset allocation examples and model portfolios, permissible under current law, already provide individuals who take the time to sift through the information with a good roadmap to the investment alternatives under their plan.

However, this information continues to be insufficient, and often still too complex, for many participants. Many participants simply want to be told more specifically where to invest their plan funds. As a result, some employers and plan service providers have sought to provide more specific and individualized investment advice to plan participants. AARP agrees that such individualized advice can be helpful, but such advice must be subject to ERISA's fiduciary rules, based on sound investment principles, and protected from conflicts of interest.

Participants deserve to have access to quality investment advice, and that advice should be free from financial conflict. ERISA has long recognized that financial conflict gives rise to divided loyalties, and thus poses the risk that actions will not be taken in the sole interest of the participant. Advice providers who also stand to benefit financially from the type of advice that is given face just such a conflict. Preserving ERISA's ban on such conflict of interest transactions is necessary to ensure that the advice provider is acting for the "exclusive benefit" of plan participants.

H.R. 2269 would replace ERISA's prohibition on such conflicts of interest with a disclosure model, and would allow investment advice where a conflict exists so long as such conflicts are disclosed. AARP believes disclosure alone is not sufficient protection, nor is it the best approach in today's marketplace.

As noted, too many participants are already overwhelmed with the investment information they are currently receiving. Disclosing yet more information, which the individual would have to both understand and properly weigh, will be least helpful to the unsophisticated investor. Even with the disclosure of potential conflicts, the participant is not left with much real choice. The individual either chooses to accept advice that is subject to a conflict, or the individual can choose no advice at all. Providing pension participants with qualified advice is simply not the best approach.

Just last year, the Securities and Exchange Commission (SEC)— whose disclosure model is often cited as instructive in this context—issued rules related to conflicts of interests for accounting firms that audit and provide other services to the same client. Chairman Levitt's pointed comments that: "Without confidence in an auditor's objectivity and fairness, how can an investor know whether to trust the numbers?" are applicable for the individual participant in this context as well. Disclosure alone, while important, does not always mitigate the potential problems that will arise as a result of financial conflicts of interest.

In fact, the Committee on Compensation Practices – also known as the "Tully Commission" (named for its Chairman, Daniel Tully of Merrill Lynch) – which was formed by the SEC to review conflicts of interest in the brokerage industry, reported in 1995 that "the prevailing commission-based compensation system inevitably leads to conflicts of interest among the parties involved." The report further stated that "...conflicts of interest persist and have been underscored by some widely publicized incidents in which the actions of certain brokerage firms and their representatives clearly damaged the interests of their clients." This is not to suggest that all advice that may entail conflict is inevitably bad advice. However, such advice, given by an advisor with a financial stake in the recommended product, needlessly subjects that advice to potential bias and interests other than the sole interest of the participant. In addition, participants must understand and weigh yet another factor in determining whether to follow that investment advice.

Earlier this year, Congress held hearings on yet another example of the problematic influence of conflict in the financial markets. The hearings followed on the heels of press coverage of the conflicts in Wall Street firms between analysts' ratings on companies and the firms' own financial interests in promoting their investment banking business. Indeed, despite the recent market downturn from an over inflated market, only one percent of analysts' reports had "sell" ratings. In fact, one study concluded that "the recommendations by underwriter analysts show significant evidence of bias." The New York Times noted the need for regulations to "protect investors from conflicted advice that undermines the integrity of the nation's financial markets."

If advice subject to conflict were the only avenue available, then such an alternative would deserve greater attention. However, plans currently have other options to provide investment advice. Financial institutions and other firms may provide advice to participants on products in which they do not have a financial interest, and plans may choose to make such advice available. In fact, a recent 401(k) benchmarking survey indicated that the number of firms using Web-based investment advice is growing rapidly. The survey indicates the service is now available to about 1 out of every five plans. In addition, the number of large financial service providers who have developed alliances with an independent investment advisor is also growing, and most of the large 401(k) providers now have an independent investment advisor available. (The use of independent advisors is not the only available alternative under current law. In addition, the Department of Labor may grant exemptive relief, as it has done in some instances, provided that certain conditions are included to protect plan participants.)

In light of these other alternatives, it is premature to weaken ERISA's current conflict of interest rules that have served both participants and pension plans well. As we have noted, the application of individualized investment advice to plan participants is in its early stages. As a result, Congress should first encourage the growth of and greater competition among independent and non-conflicted advice options. Indeed, Congress can further encourage employers to provide such advice by clarifying that the employer would not be liable for specific investment advice so

long as the employer undertook due diligence in selecting and monitoring the advice provider.

In Interpretive Bulletin 96-1, the Department of Labor indicated that the designation of an investment advisor to plan participants would not, in and of itself, give rise to fiduciary liability that is the result of the individual's exercise of control. However, as with any service provider, the plan fiduciary would be responsible for the prudent selection and periodic monitoring of the advisor. Currently, the rules applicable to an advisor should be similar to that of any plan service provider. The Department of Labor has indicated the plan fiduciary must engage in an objective process to obtain information to adequately assess the qualifications of the provider, the quality of the services offered, and the reasonableness of the fees. In addition the Department has indicated such process should avoid self-dealing, conflicts of interest, or other improper influence.

The Department last year stated that as applied to the selection of an investment advisor, a fiduciary should take into account the qualifications of the advisor, including registration under any applicable federal and state securities laws, the extent to which the advisor acknowledges its fiduciary status under ERISA to participants, and the extent to which the advisor can provide informed, unbiased, and appropriate investment advice to participants. An employer would also be required to periodically review the performance and qualifications of the advisor, including any comments or complaints about the services.

AARP believes we should encourage employers to provide advice under these basic fiduciary standards, and thus permit employers to offer investment advice without significant risk of liability. Encouraging independent unbiased investment advice will better enable employees to improve their long-term retirement security while minimizing the potential for employee dissatisfaction and possible litigation. AARP believes it is in the best interest of both the plan and plan participants to pursue these avenues prior to carving out an exemption to one of ERISA's basic prohibitions and opening the door to the potential for conflicted advice.

Should some continue to desire to permit those subject to a conflict of interest to provide investment advice, there may be potential areas where the existence of such an alternative may be acceptable. Some may believe that competition will be improved if large service providers can offer advice to participants. Of course, there is nothing in the law to prevent large or small service providers from entering the independent advice market. These firms may compete with others to provide advice to employees so long as these providers do not also have investment products in the plan. Others may believe that providers should be permitted to offer advice on their own products despite the conflict and self-dealing faced by such a provider. One alternative may be to allow a conflicted advisor to provide advice so long as the plan also makes available at least one other alternative independent advisor on the same terms and conditions for plan participants. In this way, the employee always has a choice to seek independent advice.

A second preferred approach may be to require a higher duty for the plan sponsor in the event that the plan sponsor chooses an investment advisor that is subject to a conflict of interest. For example, the plan sponsor may be required to do more than simply meet prudence requirements for the selection and monitoring of the plan. The plan sponsor could have the added duty (and added liability) of evaluating the quality of the advice provided to participants to determine if it is free of bias and in the best interests of plan participants. The burden would thus be shifted to the employer to ensure quality advice that is free from bias.

Again, we commend the committee for addressing an issue that deserves attention – the growing need for more individualized investment advice in the individual account context. AARP also applauds the recognition of the importance of disclosure, which should be an essential component of any legislation in this area. However, disclosure alone is not enough. In order to better ensure protection for plan participants, we urge the committee to focus its efforts on ways to encourage employers to make available investment advice without the potential for conflicts of interest. Such independent advice is already permissible under current law, and should be pursued prior to weakening current law to permit investment advice by those with an interest in their own financial products. We look forward to working with this subcommittee to further improve the ability of individuals to handle the individual investment responsibility inherent in individual account plans.

APPENDIX I - WRITTEN STATEMENT OF JOHN BREYFOGLE, PRINCIPAL, GROOM LAW GROUP, WASHINGTON, D.C., ON BEHALF OF THE AMERICAN COUNCIL OF LIFE INSURERS, WASHINGTON, D.C.

Testimony of Mr. Jon Breyfogle

Principal, Groom Law Group on behalf of the American Council of Life Insurers

Before the Employer-Employee Relations Subcommittee

July 17, 2001

My name is Jon W. Breyfogle and I am testifying on behalf of the American Council of Life Insurers ("ACLI"). I am a principal in the Washington, D.C. employee benefits law firm of Groom Law Group, Chartered, where I have worked with the ACLI and many of its member companies on this and many other ERISA issues over the past several years.

ACLI is the major trade association of the life insurance industry, representing more than 400 life insurance companies. ACLI member companies hold 80% of all of the assets of U.S. life insurance companies and represent 82% of the industry's retirement plan business. Retirement plan assets managed by life insurance companies total more than $1.8 trillion, approximately one-fifth of all privately-administered pension and retirement plan assets in the United States.

ACLI thanks the subcommittee for the opportunity to testify and applauds the subcommittee's continued interest in reviewing and modernizing the Employee Retirement Income Security Act of 1974 ("ERISA"). The bipartisan review begun by Chairman Boehner and Representative Andrews last year represents the first time Congress has looked in depth at ERISA's fiduciary and prohibited transaction rules and considered whether changes to the law are needed in light of the many changes that have occurred in the retirement plan market place in the 26 years since ERISA's enactment.

ACLI strongly supports the Retirement Security Advice Act of 2001 (H.R. 2269), which was first developed and introduced last year by Chairman Boehner after the subcommittee completed a series of oversight hearings. In addition, ACLI supports efforts by the subcommittee to develop legislation that would even more broadly modernize ERISA prohibited transaction rules, such as the comprehensive legislation Mr. Boehner introduced last year.

Over a year ago, in testimony before this subcommittee, the ACLI identified several key reasons why investment advice legislation, as well as more comprehensive legislation, is needed.

First, since ERISA was adopted, retirement plans have steadily moved from

traditional defined benefit plans towards defined contribution plans (e.g., 401(k) plans) and individual retirement accounts ("IRAs"). Now, more than $5 trillion is held in defined contribution plans and IRAs where employees make investment choices and assume investment risk. During this same time period, there has been tremendous growth in the number of new investment options available to participants, including thousands of new mutual funds, new types of insurance arrangements and self-directed brokerage windows through which participants can invest in almost any debt or equity security. More and more, the retirement security of millions of Americans turns on how well they make investment decisions among a more varied and complex set of investment choices.

At the same time, ERISA's prohibited transaction rules – as interpreted and administered by the Department of Labor ("DOL") – have discouraged the delivery of individualized investment advice services to plan participants. Under these rules, employers are concerned about providing investment advice themselves because they could assume fiduciary responsibility and liability for employee investment decisions. In contrast, the financial services firms that provide investment options and administrative services to employer plans are experienced and willing to provide advice services, but they are effectively barred from providing such services under ERISA's prohibited transaction rules.

Financial services firms have been largely blocked from providing specific investment advice to plan participants because the DOL has construed ERISA's prohibited transaction rules, which were adopted to prohibit self-dealing and kickbacks, to prohibit financial services firms giving specific investment recommendations on any investment options where the firm may receive an additional fee as a result of the participant's investment decision (e.g., receipt of advisory fees from the firm's proprietary mutual fund or the receipt of a 12b-1 fee from unaffiliated mutual funds).

Under DOL's approach, financial services firms must either avoid giving specific investment recommendations, or they are required to obtain individual exemptions from the DOL before advice services can be delivered. When financial services firms seek such exemptions, the DOL imposes significant "product design" conditions that regulate the types and amount of fees or require the use of independent third parties in developing asset allocation and advice programs. Notably, DOL's recent exemption activity represents a departure from its approach in the 1970s and 1980s, when it issued a number of class exemptions from ERISA's conflict of interest rules for the sale of insurance products and securities that mainly conditioned relief on disclosure and consent by plan fiduciaries.

Because of DOL's recent approach to advisory programs, the only persons who can clearly provide specific investment advice under current law without obtaining a burdensome exemption are completely unaffiliated persons that have no established relationship with employers, plans and participants. Many of these vendors are start up companies that provide advisory services mainly over the internet. While there is clearly a role for such vendors, they alone will not close the "advice gap."

Employers and participants will benefit from being able to choose among advice services offered by both independent providers and full-service financial services firms. Financial services firms offer in-person or telephone advisory services through their networks of thousands of agents, brokers and advisers, in addition to internet services. In addition, as a practical matter, employers that sponsor plans may not make advice services available to plan participants if they are required to separately contract with someone other than the financial services firm that administers the 401(k) plan to provide advice. Larger employers generally want service providers with a nationwide capability that have an existing understanding of their plan and participants. Most employers want to use one service provider to facilitate the provision of investment options, handle recordkeeping and administrative services, as well as to coordinate the provision of investment advice and education. Under these arrangements, employers are able access both affiliated and unaffiliated investment options through a single service provider, but they are unable to access advisory services from the same provider. Allowing the financial services firm that makes available the employer's defined contribution plan to provide advice – rather than requiring the employer to separately arrange for such services by another firm – will result in more employers offering advisory services to plan participants and will likely lower plan costs for such services.

There have been three additional developments since last year that further highlight the need for Congress to enact the Retirement Security Advice Act.

First, the volatility in the investment markets actually serves to reinforce the need for participants to be able to access sound investment advice. Without proper advice and education, participants may be tempted to make short-term investment decisions based solely on the recent market activity. Financial advisers can educate participants on the need to take into account the appropriate time horizons for their investment decisions, the need for diversification, the relative volatility of equity versus debt investments, and the long term expected returns on different types of categories of investments. Most importantly, advisors can help participants choose among specific investment alternatives to develop a portfolio best suited for their needs. These services are even more critical in a volatile investment environment.

Second, the sponsors of the Retirement Security Advice Act have stated that their bill is intended to close the "advice gap" created by current law. ACLI has conducted and released a new survey that clearly documents the advice gap and participant demand for investment advice. The ACLI survey indicates the following:

> Nearly half of defined contribution plan and IRA investors are "not at all" (8%) or only "somewhat comfortable" (41%) making their own investment decisions;
>
> By a 20 point margin (55% to 35%), participants support changing the law to allow financial services companies that provided their defined contribution plan or IRA to give specific investment advice; and

> By more than a 20 point margin (58% to 35%), participants support such a change in law even if the financial services firm has a financial interest in the investment options available to the participant.

Finally, earlier this year Congress passed and the President signed the "Economic Growth and Tax Relief Reconciliation Act of 2001." The tax bill includes many favorable changes to the tax rules that govern pension plans and IRAs. These proposals, authored on a bipartisan basis by Representatives Portman and Cardin, and cosponsored by many members of this committee, significantly increase the amount of contributions that can be made to all forms of defined contribution plans and IRAs. As a result, we can expect that participants will further increase the amount of retirement savings that flow into such retirement savings plans. In addition, the tax bill reflects Congress' recognition that workplace-based retirement planning is a vital component for educating participants about their retirement. Providing investment advice is an essential component of retirement planning.

ACLI believes that the Retirement Security Advice Act is both an effective, and safe, means to address the "advice gap." The bill creates a new statutory exemption from ERISA's prohibited transaction rules for "fiduciary advisers." If the many conditions of the advice exemption are met, then "fiduciary advisers" would be able to provide specific investment recommendations and receive fees that may vary somewhat based on the investment choices made by participants. However, the legislation includes the following crucial protections that ensure that participants are protected from conflicts of interests:

> ERISA's fiduciary rules continue to apply to the provision of advice by the fiduciary-adviser. These rules require that fiduciary-advisers act prudently and solely in the interests of participants. Simply put, under these rules, it would be illegal for a fiduciary adviser to make specific investment recommendations for the purpose of increasing their (or their firm's) compensation. The adviser would be personally liable to make up any losses caused by a breach of fiduciary duty and would be subject to civil penalties.
>
> ERISA's fiduciary rules will continue to apply to the employer who selects the fiduciary adviser. Thus, the employer must act prudently and solely in the interest of participants in selecting and periodically monitoring the advisor. However, the bill does make clear that employers who fulfill these duties will not be liable for the specific advice given by the fiduciary adviser.
>
> The bill limits the provision of advice to "fiduciary advisers." Fiduciary-advisers are financial services firms that are comprehensively regulated under other federal or state securities, insurance or banking laws.
>
> The bill mandates the provision of significant disclosures before the

fiduciary adviser may give any advice. Such disclosures will inform participants of any financial interest the fiduciary adviser may have, the nature of the adviser's affiliation (if any) with the available investment options, and any limits that may be placed on the adviser's ability to provide advice. These types of disclosure obligations, along with fiduciary duties, have worked well in regulating the conduct of advisers under federal securities laws for more than 60 years. Similar disclosures have also worked well for existing DOL class exemptions that cover the purchase of insurance contracts and affiliated mutual funds.

The bill keeps participants in control of their investment decisions by requiring that investment decisions be made exclusively by plan participants – not the fiduciary adviser. The adviser may make recommendations to participants, but may not make discretionary investment decisions on behalf of participants.

All transactions must be conducted on arm's length terms and for only reasonable compensation.

ACLI strongly supports The Retirement Security Advice Act and we hope the bill is only the first important step by this subcommittee to modernize and update ERISA's fiduciary and prohibited transaction rules. The legislation strikes the right balance of allowing comprehensively-regulated financial services firms to provide specific investment advisory services, while at the same time carefully protecting the interests of plan participant. The result will be increased competition in the advisory services arena, which will improve such services, make them more widely available and lower costs.

Because the current bill strikes the right balance, ACLI believes that it is critical that the sponsors of the bill retain the basic framework of the bill as the bill moves through this committee and Congress. The sponsors of the bill should oppose efforts to narrow the scope of the bill to make it less flexible or to include the types of "product design" conditions and limitations that have encumbered advisory programs subject to DOL exemptions.

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