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RETIREMENT SECURITY: THE IMPORTANCE OF AN INDEPENDENT INVESTMENT ADVISER

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BEFORE THE

SUBCOMMITTEE ON HEALTH, EMPLOYMENT, LABOR AND PENSIONS

COMMITTEE ON EDUCATION AND LABOR

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C O N T E N T S

RETIREMENT SECURITY: THE IMPORTANCE OF AN INDEPENDENT INVESTMENT ADVISER

Tuesday, March 24, 2009
U.S. House of Representatives
Subcommittee on Health, Employment, Labor and Pensions
Committee on Education and Labor
Washington, DC

The Subcommittee met, pursuant to call, at 10:30 a.m., in room 2175, Rayburn House Office Building, Hon. Robert Andrews [chairman of the Subcommittee] presiding.

Present: Representatives Andrews, Wu, Hare, Tierney, Kucinich, Fudge, Kildee, Sestak, Courtney, Kline, Guthrie, Hunter, and Roe.

Staff present: Aaron Albright, Press Secretary; Tylease Alli, Hearing Clerk; Carlos Fenwick, Policy Advisor, Subcommittee on Health, Employment, Labor and Pensions; David Hartzler, Systems Administrator; Ryan Holden, Senior Investigator, Oversight; Therese Leung, Labor Policy Advisor; Joe Novotny, Chief Clerk; James Schroll, Staff Assistant, Labor; Michele Varnhagen, Labor Policy Director; Robert Borden, Minority General Counsel; Cameron Coursen, Minority Assistant Communications Director; Ed Gilroy, Minority Director of Workforce Policy; Rob Gregg, Minority Senior Legislative Assistant; Alexa Marrero, Minority Communications Director; Jim Paretti, Minority Workforce Policy Counsel; and Linda Stevens, Minority Chief Clerk/Assistant to the General Counsel.

Chairman ANDREWS [presiding]. The Committee will come to order. Good morning, ladies and gentlemen.

Good morning, ladies and gentlemen. We welcome our witnesses. We thank our colleagues for their attendance, and we welcome the ladies and gentlemen of the public for being with us this morning.

If I could characterize the present state of financial distress in which we find our country and our world, I think that much of that distress could be tied back to the unwelcome development of conflict of interest.

Conflict of interest has been institutionalized in the last number of years in our law books, in our business practices, and unfortunately the consequences of those conflicts of interest are felt by every American and every citizen of the world in some way, very negatively today.

It began with some work this Committee did, what now seems like a long time ago, in the Enron scandal. And one of the findings that came out of our work on the Enron scandal was the realization that firms that used to be honest arbiters of public accounting had somehow morphed into promotion entities for people raising and transacting in capital.

And out of that grew the efforts by Senator Sarbanes and former member Chairman Mike Oxley that dramatically changed the world of accounting and financial services.

We saw another manifestation of that conflict of interest far too late in real estate lending. It used to be in real estate lending that the person who originated the loan generally maintain an interest in whether or not the loan was repaid. And so those loan's originators were careful about to whom they loaned, how much they loaned, and under what circumstances.

Over time, a conflict of interest evolved in that field, and whole industry grew up in originating, securitizing, and selling loans, where the profit was derived not from the collection of the loan, but from the origination and packaging of the loan.

Conflict of interest really then grew between those who had an interest in originating as many loans as they could to whomever they could, irrespective of the creditworthiness of that person, and the more natural interest in collecting the loan once it was made.

We believe that that same conflict of interest problem is now exposing itself quite potentially to $9.2 trillion worth of pension assets held by Americans in their defined contribution accounts and individual retirement accounts.

Ninety million Americans have either a defined contribution account, an IRA, or both. Those accounts hold $9.2 trillion in them.

In the last hours of the prior administration, a rule was issued that many of us have significant concerns with because we believe that it runs the risk of spreading that conflict of interest disease to this world of pension and IRA holdings.

Chairman Miller, myself, Senator Kennedy, and Senator Grassley have expressed our concerns about this rule to the administration, and as a result our former colleague, now Secretary Solis, in response to a decision by the President, has subjected this new rule to a period of review.

Our concern is that the proposed new rule has two significant weaknesses. The first is that employees of an affiliate organization to a money manager or financial manager may now be free to give unfettered and conflicted advice in a way that could well cause harm to the pensioner or to the citizen.

And the second concern that we have is that an employee directly employed by that money manager or financial firm may have the ability to simply make a rudimentary review of the findings of an independent computer model and then quickly move on to other fields of advice that could expose the assets of that pensioner or citizen to undo risk.

We believe that that is the nature of the risks posed by the rule. And in part, today's hearing will focus on the pros and cons of that rule, the consequences and perhaps benefits of that rule.

But I do want the witnesses to go beyond that, and I would invite our colleagues to go beyond that, to consider more broadly the question of, what extent, to any, we should institutionalize conflicted investment advice in the pension arena?

And if we should choose not to do that—and I favor that we don't have conflicted advice in that arena—what is a way that we could supplant conflicted investment advice with what I believe strongly is the preferred alternative, which is qualified, independent investment advice?

We have assembled a very strong panel this morning with some widely varying points of view on this topic, on these topics. And we will hear from each of the witnesses this morning.

This is the first in a series of hearings that this Subcommittee will conduct on the whole question of Americans and their pensions. The Full Committee has laid some of the groundwork for this work, both in the fall and the prior Congress, with the work that we did together on the fee disclosure issue, and more recently the Full Committee hearing on the question following up on fee disclosures, where Mr. Bogle and others testified.

So we look forward to a vigorous exploration of these issues. We are glad that our colleagues could join us this morning.

And at present, I would like to turn to my friend, the senior Republican on the Subcommittee, Mr. Kline from Minnesota, for his opening statement.

Prepared Statement of Hon. Robert E. Andrews, Chairman, Subcommittee on Health, Employment, Labor and Pensions

Good morning and welcome to the Health, Employment, Labor, Pensions (HELP) Subcommittee's hearing on "Retirement Security: The Importance of an Independent Investment Adviser."

On the eve of the inauguration of President Barack Obama, the Bush administration attempted to finalize a regulation concerning the Employee Retirement Income Security Act (ERISA) that raised substantial questions of law and policy. Essentially, the final rule issued would have allowed conflicted financial advice to workers with regard to their 401(k) and other types of defined contribution plans.

Fortunately, thanks to letters of opposition from Chairman Miller and myself, as well as several other Members of Congress, as well as consumer advocacy groups and several financial industry insiders who serve in the interest of investors, the Obama administration has delayed the effective date of the regulation for further examination of its intent.

I believe in the value of providing American workers with access to investment advice, so long as the advice is independent and free from conflict—serving in the interest of the worker, rather than him or herself. During a time where American workers have already lost $2 trillion in assets due to last year's market downturn, exposing their hard-earned retirement savings to greater risk by allowing advisers to offer them conflicted advice is irresponsible and imprudent.

Many of my colleagues during consideration of the Pension Protection Act of 2006 were well intended with respect to ensuring that if workers' were to receive investment advice with respect to their retirement savings, it would be independent. Despite their good intentions, the manner in which the process unfolded for the bill's consideration muddled their intent, paving the way for creation of a statutory loophole so that conflicted advice could be offered to participants through the regulatory process.

Today's hearing provides those individuals in favor of giving participants the choice of non-conflicted investment advice, an opportunity to be heard and reject the Bush administration's investment advice regulation, which would expose millions of Americans to the Madoffs of the world.

I thank all of the witnesses for coming before us today and look forward to hearing their testimony.

Mr. KLINE. Thank you, Mr. Chairman.

Good morning to everyone. Thanks to the witnesses for being here. It is, indeed, a distinguished panel, and I hope we do have some very spirited discussion on all sides of the issue.

We are here this morning to examine an issue that is enormously complex, but based on a principle that is remarkably simple. Simply put, today literally billions or trillions, as the chairman has pointed out, dollars of investment savings and participant-directed retirement accounts are being managed by individual plan participants.

For the layman in our room, that means that decisions about, oh, say, a 401(k) investment that will have consequences 5, 10, or 30 years down the road, these decisions are being made by people like you and me, not necessarily by the people sitting down here on the panel, or a colleague, or a neighbor, and too often without any sound financial advice on which to base them.

Why has this historically been the case? Perhaps for many reasons, not the least of which is the fact that, for far too long, the ERISA statute which provides much needed protections to millions of workers and retirees stood in the way of workers' access to this advice.

Through so-called prohibited transaction requirements in that law, workers were too often unable to access personal, individualized, quality investment advice in the workplace.

That is why in 2006 Congress enacted with overwhelming bipartisan support the Pension Protection Act. As you may recall, that bill did many things, but of greatest relevance to today's hearings, it created concrete measures to ensure individual plan participants could have access to the quality investment advice they so desperately needed.

Indeed, in some ways, I would argue this provision is even more important today than it was 2½ years ago. Given our current economic downturn and its repercussions on individuals' retirement savings, the need for quality investment advice is more critical than ever.

In the years following the enactment of the Pension Protection Act, and as directed under the law, the Department of Labor issued regulations implementing the investment advice provisions of the act. While these final regulations were published in January of this year, the effective date of these regulations has been suspended by the incoming Obama administration, as the chairman pointed out.

The administration announced last Friday they would continue to solicit comment on whether the regulation should move forward, be suspended, or be otherwise modified. I would hope the department approaches this question in a thoughtful and deliberative manner and does not simply go through the motions to repeal these regulations for political or ill-advised reasons.

I suspect we will hear a lot about the department's regulations today, both from those who support them and those who will criticize them.

I think it is important, however, to have a very clear record of what these regulations are and what it is not. Some have attempted to characterize these as last-minute midnight regulations stuck into the federal register in the last days of the Bush administration without ever having seen the light of day or been given serious scrutiny.

Others have characterized these measures as a giveaway to the financial services community that will simply fill the coffers of investment advisers who will be free to provide so-called conflicted investment advice without sanction.

Both of these characterizations are simply, I believe, flatly wrong. To refute those who claim this regulation was a last-minute attempt to shove through unseen proposals, I would simply look to the record. The Pension Protection Act, including investment advice provisions, were signed into law in August of 2006.

Before the end of that year, in December, the Department of Labor published a request for information from all parties seeking guidance and input as the shape of regulations under the new law.

In August of 2008, the department published proposed regulations again vetting them for public comment from all stakeholders. Later that year, in October, the department held a public hearing on the proposed rules to which interested members of the public were invited to comment on the proposals and recommend change.

Finally, and only after this extensive public vetting process, the department published its final regulations January 21, 2009, in the federal register.

Now, we can and, frankly, I expect we will debate the wisdom of choices the department made and what was included in these final regulations, but the claim that they were not given full and open debate and consideration is simply to re-write history.

Those who claim the regulation is a parting gift of financial services companies, I again say a check of the facts is in order.

I am anxious to get to the hearing today and to hear from our very, very distinguished panel of witnesses. And I know that you have all been briefed on the rules, and the chairman will brief them again. We have a lot of ground to cover.

And, again, I want to thank you for attending today.

I yield back.

Prepared Statement of Hon. John Kline, Ranking Republican Member, Subcommittee on Health, Employment, Labor and Pensions

Good morning, Chairman Andrews, and welcome to our distinguished panel of witnesses.

We're here this morning to examine an issue that is enormously complex, but based on a principle that is remarkably simple.

Simply put, today, literally billions of dollars of investment savings in participant directed retirement accounts are being managed by individual plan participants. For the laymen in our room, that means that decisions about, say, 401(k) investments that will have consequences five, ten, or thirty years down the road are being made by people like you and me, or a colleague or a neighbor—too often without any sound financial advice on which to base them.

Why has this historically been the case? Well, perhaps for many reasons, not the least of which is the fact that for too long, the ERISA statute—which provides much-needed protections to millions of workers and retirees—stood in the way of workers' access to this advice. Through so-called "prohibited transaction" requirements in that law, workers were too often unable to access personal, individualized, quality investment advice in the workplace.

That's why, in 2006, Congress enacted with overwhelming bipartisan support the Pension Protection Act—or PPA. As you may recall, that bill did many things, but of greatest relevance to today's hearing, it created concrete measures to ensure individual plan participants could have access to the quality investment advice they so desperately needed. Indeed, in some ways, I would argue this provision is even more important today than it was two-and-a-half years ago. Given our current economic downturn and its repercussions on individuals' retirement savings, the need for quality investment advice is more critical than ever.

In the years following the enactment of the PPA, and as directed under the law, the Department of Labor issued regulations implementing the investment advice provisions of the act. While these final regulations were published in January of this year, the effective date of these regulations has been suspended by the incoming Obama Administration, which announced last Friday they would continue to solicit comment on whether the regulations should move forward, be suspended, or be otherwise modified. I would hope the Department approaches this question in a thoughtful and deliberative manner, and does not simply "go through the motions" to repeal these regulations for political or ill-advised reasons.

I suspect we'll hear a lot about the Department's regulations today—both from those who support them and those who will criticize them. I think it is important, however, to have a very clear record of what these regulations are, and what it is not.

Some have attempted to characterize these as last-minute "midnight" regulations, snuck into the Federal Register in the last days of the Bush Administration, without ever having seen the light of day or been given serious scrutiny. Others have characterized these measures as a "giveaway" to the financial services community that will simply fill the coffers of investment advisors who will be free to provide so-called "conflicted" investment advice without fear of sanction. Both of these characterizations are simply, flatly, wrong.

To refute those who claim this regulation was a last-minute attempt to shove through unseen proposals, I would simply look to the record. The Pension Protection Act, including investment advice provisions, was signed into law in August of 2006. Before the end of that year, in December 2006, the Department of Labor published a request for information from all parties, seeking guidance and input as to the shape of regulations under the law.

In August 2008, the Department published proposed regulations, again vetting them for public comment from all stakeholders. Later that year, in October, the Department held a public hearing on the proposed rules, to which interested members of the public were invited to comment on the proposals and recommend change. Finally, and only after this extensive public vetting process, the Department published its final regulations January 21, 2009 in the Federal Register.

Now we can, and I expect we will, debate the wisdom of choices the Department made, or what was included in these final regulations—but to claim they were not given full and open debate and consideration is simply to rewrite history.

To those who claim the regulation is a parting gift to financial services companies, I again say a check of the facts is in order. As we will hear today, these regulations are highly protective of participants, indeed, imposing ERISA fiduciary duties—some of the strictest under law—on investment advice providers. As testimony will reflect, many of the policy choices made by the Department are decidedly pro-participant and protective in scope. I hope that in our debate today, and going forward, we focus on these facts and stay on that "higher ground."

With that, I am mindful that our witnesses' time is precious, and I am eager to hear what they have to say. I again welcome our witnesses and yield back my time.

Chairman ANDREWS. I thank the gentleman from Minnesota.

Without objection, opening statements from other members of the Subcommittee will be accepted into the record.

Well, I would like to thank the staff on both the Democratic and Republican side for assembling a terrific panel of witnesses.

As my friend, Mr. Kline, said, we do have rules that attempt to abbreviate oral testimony to facilitate more questions and answers from the members to the panel. Without objection, the written statement of each of you will be made a part of the record in their entirety.

Each of you will be given 5 minutes to summarize your oral testimony. I think you are familiar with the light system that we have, some of you are, I know, that when the green light goes on, you should begin your testimony. The yellow light indicates you have about a minute left, and we would ask you to start concluding your testimony. And the red light means we would ask you to wrap up and stop so we can move on.

I am going to read the biographies of each of the panelists, and then we will come back to Mr. Bullard, Professor Bullard, and start with you.

Mercer Bullard is an associate professor of law at the University of Mississippi School of Law, in addition to being the founder and president of Fund Democracy, a nonprofit advocacy group for mutual fund shareholders. He founded Fund Democracy in January 2000 to provide a voice and information source for mutual fund shareholders on operational and regulatory issues that affect their fund investments.

Professor Bullard has also served as an expert witness for both plaintiffs and defendants—not at the same time, I am sure—in a variety of securities cases and a senior adviser with the financial planning firm of Plancorp, Inc. Mr. Bullard has a J.D. from the University of Virginia School of Law, an M.A. from Georgetown University, and a B.A. from Yale College.

Welcome, Professor. We are glad that you are with us.

Ms. Melanie Nussdorf is a partner with the Washington office of Steptoe & Johnson LLP, where she is a member of their tax and employee benefit groups. Ms. Nussdorf represents a number of financial institutions, including major banks, brokerage houses, and insurance companies. She has a J.D. from the New York University School of Law and a B.A. from the University of Pennsylvania.

Ms. Nussdorf, we are glad to have you with us today.

Sherrie Grabot—did I pronounce that correctly?

Ms. GRABOT. Grabot.

Chairman ANDREWS. Grabot. Okay, Sherrie Grabot is the CEO of the GuidedChoice, which was founded in 1999 with Harry Markowitz, PhD, Nobel laureate, as an independent advisory company. In the 1980s, Sherrie was responsible for building some of the earliest 401(k) software products and recordkeeping systems.

In the early 1990s, she was the first to automate a 401(k) plan at the desktop. As manager of H.R. systems and financial programs at Apple Computer, Inc., she spearheaded the automation of Apple's 401(k) plan. She recently served as chairman of the Department of Labor's ERISA advisory council and continues to be a leader in the evolution of 401(k) at the national level.

Ms. Grabot, thank you very much for coming this morning.

Andrew L. Oringer co-heads the U.S. executive compensation and benefits practice—must be an interesting time—at the White and Case law firm in New York City. Mr. Oringer has published numerous articles on such topics as the fiduciary rules under the Pension Protection Act, executive compensation, the tax rules governing non-qualified deferred compensation, the ERISA implications of structuring investment funds, plan assets, the treatment of employee benefits in bankruptcy, and ESOPs.

He has a J.D. from Hofstra University School of Law and an MBA from Adelphi University and an A.B. from Duke University. He will be commenting on the Duke-Villanova game, I am sure, at some point today.

Welcome, Mr. Oringer. Glad that you are here with us.

Ken Baker is the corporate director of human resources for Applied Extrusion Technologies. Mr. Baker worked as an engineer for both FMC and Hercules Incorporated, where he also managed information systems. He spent 2 years in the U.S. Army and received a B.S. in engineering from West Virginia University.

Welcome, Mr. Baker. We are glad that you are here.

And, finally, Mr. Charles Jeszeck—did I pronounce your name correctly? Mr. Jeszeck is currently Assistant Director for Education, Workforce and Income Security Issues at the U.S. Government Accountability Office. He has spent almost 24 years with the GAO leading research on retirement and labor policy issues, on which we have drawn from your expertise very frequently, providing information to members of Congress and their staff on these matters.

Before joining the GAO, Mr. Jeszeck taught economics at the University of Massachusetts in Amherst, at Barnard College, and worked in the research departments of the Service Employees International Union, SEIU, and the California Labor Federation AFL-CIO. He received a PhD in economics from the University of California, Berkeley, in 1982.

Pretty good panel. I think people really know what they are talking about.

Mr. Bullard, we are going to start with you. You have 5 minutes to summarize your testimony, and we will begin.

STATEMENT OF MERCER BULLARD, ASSOCIATE PROFESSOR, UNIVERSITY OF MISSISSIPPI

Mr. BULLARD. Chairman Andrews, Ranking Member Kline, and members of the Subcommittee, thank you for the opportunity to appear before you today to discuss the importance of independent investigation advice.

Investment advice is important because without it many retirees in defined—participants in defined contribution plans will reach retirement without enough income to live on. Many participants contribute too little to their pension plans to provide for their retirement. When choosing from among different plan options, many participants often take too much or too little risk. The Department of Labor has found that they pay higher fees than necessary.

Independent investment advice can help participants understand the importance of early and regular contributions to pension plans, to make the right investment choices in their plans, and to stick with those choices during periods of market volatility.

For many participants, the availability of independent investment advice will determine whether they achieve financial security in retirement. The availability of independent investment advice to plan participants also has systemic consequences for our political and economic institutions. To the extent that our system of private pensions fails to provide for retirees' financial independence, societal demands on Social Security, Medicare, and other public welfare programs will increase.

One limitation on the providing of independent investment advice to plan participants is the perceived liability risk for employers under ERISA. It is appropriate to create limited safe harbors to protect employers who include independent investment advisory services in their pension plans.

It is not appropriate, however, to create such safe harbors for employers to provide conflicted investment advice. Indeed, ERISA's prohibited transaction provisions were designed to prevent such conflicts of interest.

The Pension Protection Act's conflicted advice exemption, especially as interpreted and expanded by the Department of Labor, promotes conflicted investment advice. Advisers will steer participants to investment products that are more profitable for the adviser's employer and affiliates rather than those that are best suited to participant's needs.

For example, the Department believes that conflicts can be eliminated as long as the adviser's compensation appears not to vary based on the investment products selected, even while the adviser's employer and its executives and the supervisors of the adviser receive higher fees from an affiliate when the adviser recommends an affiliate's more profitable products to participants.

It is absolutely certain that these incentive payments will affect the adviser's recommendations regardless of whether the adviser's compensation is facially neutral.

The Department's exemption for computer-based recommendations does not even attempt to prevent the adviser himself from being directly compensated for recommending an affiliate's most profitable products.

The conflicted advice exemption also will have the effect of squeezing out independent advice—service providers will package conflicted advice, along with investment products and recordkeeping, and charge a bundled fee for all of these services.

Independent advisers will have to charge an additional fee in order to get paid, which will create the appearance of participants who are already paying the bundled fee paying twice for investment advice.

The conflicted advice exemption will introduce the kinds of sales abuses that are commonplace in the retail mutual fund industry to 401(k) participants. For example, under current law, retail mutual fund salesmen are allowed to steer clients to the mutual funds that pay them the highest compensation. They are not even required to disclose these under-the-table kickbacks to their clients.

Some of these practices already have become firmly ensconced in the private pension world. In a study of pension consultants, the SEC found that more than half of the consultants they inspected were being compensated by the money managers that the consultants recommended to their pension plan clients.

The GAO found that the clients of pension consultants that do not disclose significant conflicts of interest experienced lower investment returns. And these are the cases where presumably sophisticated plan sponsors are being exploited.

Imagine what practices will evolve when conflicted advisers are allowed to victimize unsophisticated 401(k) participants. Many will treat participants fairly, but many will not.

In conclusion, I strongly encourage the Committee to seek the repeal of the PPA's conflicted advice provision. While much of the damage has been caused by the Department's interpretive guidance and its class exemption, the statutory exemption alone has the effect of promoting conflicted advice.

In addition, the Committee should consider legislation that prohibits a person who provides investment advice to plan participants, including that person's employer and any affiliates, from receiving any compensation from the plan other than compensation received for the investment advice or any direct or indirect compensation or benefit from any other plan service provider.

This would repeal the Department's overbroad positions in Frost Bank and SunAmerica and prevent the adoption of the Department's pending class exemption, each of which effectively permits advisers to recommend products based on the additional benefits they receive rather than the best interests of participants.

The Department should be authorized to exempt only the receipt of specifically identified de minimis or offsetting benefits, as long as they do not result in any benefit to the adviser or the adviser's employer or affiliates due to the investment options selected by the participant.

Finally, an exemption for computer-based models should be retained, but it should not be used to extend protection to conflicted advice provided within the model's recommendations. It should be designed to encourage the providing of independent investment advice to participants.

Thank you.

[The statement of Mr. Bullard may be accessed at the following Internet address:]

http://edworkforce.house.gov/documents/111/pdf/testimony/20090324MercerBullardTestimony.pdf

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Chairman ANDREWS. Professor Bullard, thank you very much for your very edifying testimony.

Ms. Nussdorf, welcome to the Committee. We look forward to hearing from you.

Ms. NUSSDORF. Thank you, Chairman Andrews.

Chairman ANDREWS. You need to turn your microphone on.

Ms. NUSSDORF. That work?

Chairman ANDREWS. That is fine. Thank you.

STATEMENT OF MELANIE NUSSDORF, PARTNER, STEPTOE AND JOHNSON, SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION

Ms. NUSSDORF. Okay. Good morning, Chairman Andrews, Congressman Kline, Members of the Subcommittee.

I represent the Securities Industry and Financial Markets Association, and we are pleased to be able to testify before you today.

Prior to the enactment of the Pension Protection Act, policymakers consistently cited the need for more professional advice for participants with respect to their retirement savings. Too small a percentage of American workers have access to professional advice from people who are fiduciaries and who subject themselves to the fiduciary requirements of ERISA.

Current market conditions have adversely affected retirement security, and especially employees' confidence in their ability to retire on a financially secure basis.

Our member firms hear every day that benefit plan clients would like additional advice and support on retirement planning, investment allocation, and strategies for these assets. Without additional professional investment advice in the marketplace, this situation will not change. And I don't think there is anyone on the Committee or on this panel who would disagree with that.

It might be helpful to provide just a little bit of context. Under ERISA and the internal revenue code, every person who provides services to a retirement plan or an IRA is a party in interest, and parties in interest can't sell products to or provide services to plans or IRAs without an exemption.

Up until the Pension Protection Act, there was no exemption that was applicable to fiduciary service providers that allowed them to provide advice, except with respect to a single product, like mutual funds or bank deposits or bank collective trusts. And, of course, there are many more products out there for participants to choose from.

What was needed was a comprehensive exemption that clearly laid out the requirements for advisers to provide advice. And current advice programs just don't reach enough workers in ways that are comfortable for those workers.

The Internet-based advice products may work for some participants, and they are terrific. But in our experience, plan participants seek personal interaction with their fiduciary adviser.

If the rules promulgated under the Pension Protection Act are allowed to take effect, plan participants will have access to advice providers who offer advice on a wide variety of investments in person or on the phone in a cost-effective manner.

The Department's regulations and class exemption recognize that, as millions of more—millions more workers retire, they may seek to choose from many different kinds of investment products that can't be effectively modeled with a computer program. And as more of the population nears retirement, employers and financial services firms are working on product innovations that may or may not be feasible to model.

Reliance on computer models that include only one kind of investment product will stifle innovation or leave middle-income families with fewer choices in retirement. Let me just give one example.

Without the Department's class exemption, an adviser could not recommend that an IRA owner invest half his IRA in a product that provides level income for life and the other half in a laddered Treasury bond program, because there is no model that encompassed both of these products. Without the class exemption, a computer model provider could not respond to questions from participants that go beyond the model's output.

The final rule and the class exemption are extremely protective of participants. They are more protective than the exemptions that have been issued for conflicts in the past by the Labor Department and by Congress.

Only regulated advisers may utilize the exemption. Participants will be told that they have the option to seek advice from an adviser whose company does not sponsor investment products. In fact, every adviser who is affiliated with a financial institution will need to say to the participant, "You can have independent advice."

If the adviser recommends an investment with higher fees, he must explain why the higher-fee investment is better for the participant. All material conflicts must be disclosed in advance. And if, in fact, an adviser fails to meet the requirements of the exemption, the transaction needs to be reversed, an excise tax needs to be paid, and the adviser must disgorge its profits.

So it is a fairly severe penalty. And what is more, in the class exemption, a pattern and practice of violations will require all transactions to be reversed, even if they met the requirements of the exemption.

We believe that what is most important is that these rules will, for the first time, present the realistic chance that widespread, easily accessible, person-to-person-based fiduciary advice will be available and used by tens of millions of plan participants. We urge everyone not to lose sight of that goal.

We thank you for the opportunity to testify, and I would be happy to answer any questions you have.

[The statement of Ms. Nussdorf follows:]

Prepared Statement of Melanie Franco Nussdorf on behalf of the Securities Industry and Financial Markets Association (SIFMA)

Good Morning, Chairman Andrews, Congressman Kline and Members of the Subcommittee. I am Melanie Franco Nussdorf, a partner at Steptoe & Johnson, LLP, practicing in the employee benefits area and counsel to, and testifying on behalf of the Securities Industry and Financial Markets Association ("SIFMA"). SIFMA brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

We appreciate the opportunity to testify today on investment advice for retirement savings. Prior to the enactment of the PPA, policymakers consistently cited the need for more professional advice for participants with respect to their retirement savings. There is arguably an even greater need for such advice today, in light of the volatility and precipitous drop in the markets. Only a small percentage of American workers have the benefit of professional investment advice from individuals who hold themselves out to be fiduciaries and subject themselves to ERISA's fiduciary requirements. Current market conditions have affected retirement security and employees' confidence in their financial ability to retire. Our member firms hear everyday that benefit plan clients would like additional advice and support on retirement planning, investment allocation and strategies for these assets. Without additional professional advice in the market place, this situation will not change.

American workers' retirement savings are increasingly held in participant-directed accounts such as 401(k) plans and in IRAs, either by contribution or through rollovers from employer sponsored retirement plans. Today, about 63 percent of the full time workforce is covered by a 401(k) plan; over the next 10 years, a high percentage of these assets will be rolled over into IRAs. IRA assets totaled $4.13 trillion as of September 30, 2008—they already exceed assets in defined contribution plans, and are expected to increase further as workers retire in greater numbers and roll over their 401(k) balances. As a larger and larger percentage of these savings accumulate in IRAs which may be invested in the entire range of investment products—annuities, stocks, bonds, foreign investments, mutual funds and other pooled vehicles, investment advice is even more critical to help retirees through this wide array of investment choices.

It might be helpful to provide some context. ERISA and the Internal Revenue Code define every person who provides services to a plan as a so-called party in interest. As parties in interest, service providers are prohibited from engaging in any transaction or providing any service to a plan or an IRA unless the terms of an exemption are met. Prior to the PPA, the exemptions available to fiduciary service providers were limited to a single investment product, such as bank deposits, or mutual funds, or annuities. There was no single exemption that would allow investment advisory services to be provided by someone whose affiliates might be selling investment products, like securities, or mutual funds, or insurance contracts, or bank investment products, to a plan or an IRA unless the advisor recommended none of its affiliates' products. In 1975, Congress thought such a restriction was unrealistic; it is no more realistic now. In 2006, Congress found that the absence of a comprehensive investment advice exemption was largely responsible for the few broad investment advice programs offered by banks, insurance companies and broker-dealers. Instead, prior to the PPA, a patchwork of exemptions permit a fiduciary to provide advice on one or another product type and then sell that product. Each such exemption contains different requirements and each covers only one type of product. These exemptions often do not contemplate the various compensation arrangements in existence today. In addition, this approach discourages the introduction of innovative products designed to address longevity, inflation and market risks.

There are two problems with this patchwork approach. First, the existing exemptions do not cover many investment products or combinations of investment products that are common today. Second, without a comprehensive exemption covering all types of investments, a fiduciary advisor might be able to provide advice on stocks and bonds held in an IRA, and then act as agent in selling them to a plan or IRA, but that commission arrangement would not permit the advisor to sell affiliated mutual funds. Thus, the advice available from a large financial institution was necessarily limited. What was needed in 2006 was a comprehensive exemption that clearly lays out the requirements for advisors to provide advice to plan participants regardless of what types of investments are being recommended. The PPA addressed that need.

Congress enacted a statutory exemption in 2006 for participant directed defined contribution plans, and directed the Department of Labor to issue a separate class exemption with respect to IRAs if it found that there are no computer models capable of taking into account the full range of investment products available to IRAs.

While we recognize the utility of the current advice programs provided by independent advice providers like Financial Engines and Guided Choice, who are not affiliated with banks, broker dealers or investment companies, no exemption would have been necessary to allow these advisors to provide advice. But current advice programs do not reach enough workers in ways that are comfortable for those workers, to make professional investment advice the norm, rather than the exception. This was Congress' concern in 2006, and there has been no significant increase in fiduciary advice programs since then. The Department's regulation and class exemption would be a step closer to reaching the stated goal of the PPA's investment advice provisions.

Many advice providers depend on the Internet for the delivery of advice; while that approach may work for some participants, in our experience, plan participants seek personal interaction with their fiduciary advisor. If the rules promulgated under the PPA are allowed to take effect, plan participants will have access to advice providers who offer advice on a wide variety of investments—in person or on the phone—in a cost-effective manner. We think it is critical and beyond argument that we need to increase savings and encourage better investment decisions. We respectfully submit that professional investment advice is a critical step, and unless the ranks of fiduciary advisors multiplies greatly, it is unlikely that there will be any increase in the provision of advice to participants and IRA owners.

Comments received by the Department from individual participants and beneficiaries make clear their need for investment advice, particularly in this economy. If the current unaffiliated advice providers were satisfying that need, those comments would be unlikely. Nothing in the PPA, the Department's regulations under the statutory exemption, or the Department's class exemption would deny participants advice from unaffiliated advisors. Indeed, the Department's rules make clear that every participant must be told that he or she may receive advice from an advisor who is not affiliated with any product. This reminder serves to underscore the choices available to participants and to provide a useful alternative for those who would prefer a different course. But to limit advice to providers who have no affiliates selling products to plans and IRAs will continue the status quo—not enough advisors, not enough professional fiduciary advice.

There are more than a hundred thousand financial advisors who could and would fill this gap. So why don't they? Prior to the PPA's enactment, we think the answer was pretty clear. Under the Department of Labor's exemptions and interpretations, advisors needed to charge an outside fee from which was offset all fees from the products sold, like internal advisory fees in affiliated mutual funds and commissions from unaffiliated mutual funds. Fixed income instruments, including Treasury bonds, couldn't be sold to the plan or IRA by the fiduciary advisor at all. Often, that offset resulted in a situation where the advisor's fee was fully offset, and hugely expensive systems needed to be created to affect the accounting for the offsets. In addition, these interpretations worked best in an advisory wrap program which the SEC has criticized for buy and hold investors. Also, because of the cost associated with a wrap fee product, most financial services companies only offer this type of program to clients with large accounts—for instance more than $50,000. The PPA advice exemption is crucial to ensure that 401(k) participants and IRA owners who have small balances or who are buy and hold investors are able to get personal advice tailored to their individual goals from commission-based advisors.

The Department has issued the regulations and the class exemption called for in the statute. It provides a special rule for advice offered to a 401(k) plan participant investing through a self-directed brokerage account or to an IRA account holder where modeling is not feasible. This provision recognizes that, as millions of workers move into retirement, they may seek to choose from the many different types of investment products that cannot be modeled effectively with a computer program. IRAs may invest in stocks, bonds, CDs, currency, annuities, and many other financial products. As more of the population nears retirement, employers and financial services firms are working on product innovations that it may or may not be feasible to model. Reliance on computer models that include only one kind of investment product will stifle innovation or leave middle-income families with few choices in retirement. IRA owners are increasingly interested in investments that can't be modeled, such as bank products, securities (including Treasury instruments), annuities and pooled funds. Let me give just one example: without this class exemption, an advisor could not recommend that an IRA owner invest half his IRA in a product that provides level income for life, and the other half in a laddered Treasury bond program, because there is no model that encompasses both of these products. Nonetheless, this is certainly a program that many IRA owners might reasonably want to consider.

In addition, without the class exemption, a computer model provider could not respond to questions from participants that go beyond the model's required inputs, such as questions about suitable levels of risk. If the results of the model were unsatisfactory, a participant's only choice would be to run the model again, trying to guess at the inputs that would allow the model to provide choices that meet his or her needs. The class exemption addresses how off-model advice can be provided with sufficient safeguards, including contemporaneous recordkeeping, advance disclosure, and audit requirements that will protect participants and beneficiaries and create a record for ensuring that the requirements of the exemption and ERISA's fiduciary responsibility provisions have been satisfied.

The final rule and class exemption protect participants. Only individuals subject to oversight of insurance regulators, the SEC, or similar state agencies or banking regulators can provide advice. This adds a layer of oversight and protection to these rules that does not exist under current law, where anyone can provide advice so long as he or she follows one of the methods in the Department's existing guidance. Additional protection is found in the requirement that participants be told that they are always free to seek advice on their own from an advisor whose company does not sponsor investment products, if that is what they prefer. This information will cause all plan participants and IRA owners to focus on how much oversight, and indeed skepticism, they want to exercise with respect to their own retirement savings. Another safeguard is the requirement that if an advisor recommends an investment with higher fees, he must explain why the higher fee investment is better for the participant. The material conflicts in the advisor's advice must be fully disclosed in writing: this focused disclosure is still another protection for participants and IRA owners. A further protection is the dire consequence of failing to meet the requirements of the exemption. Not only will the transactions that failed to meet the statutory requirements have to be reversed and the client restored to the position he or she would have occupied had the investment not been made, but unlike any other exemption the Department has issued, if there is a pattern and practice of failures, all of the transactions during the period of noncompliance will lose the relief provided by the exemption and will have to be reversed, including those that did not violate the law.

Still another protection is the annual audit. The final regulation and class exemption require the fiduciary advisor to obtain an independent audit on an annual basis. This audit is protective of plan participants and consistent with other exemptions that the Department has granted in the past. The audit requirement is analogous to the so-called QPAM look alike exemptions and the in-house manager exemption which require an independent annual audit based on sampling. The audit will be done by professionals; the selection of the auditor will be subject to ERISA's fiduciary standards; and the results of the audit will be made available to plan sponsors, IRA owners, and, where there is evidence of a failure to meet the exemption, to the Department. We believe this requirement is a strong protection for participants and beneficiaries which makes the exemption administrable by focusing the Department on the situations where independent auditors found evidence of noncompliance.

The final regulations interpreting the statutory exemption and the class exemption have been subject to a thorough process of evaluation and analysis. The Department issued a Request for Information soliciting public comment before it even began to draft regulations, held two hearings, issued a Field Assistance Bulletin with its views in early 2007, and published a proposed and final regulation and class exemption, as well as a request for comments after the regulation and class exemption had been published in final form. All stakeholders have been heard. While some may disagree with the investment advice exemption in the statute, or with Congress' mandate to the Department to determine whether models exist that can appropriately model any investment in which an IRA may invest, the final regulation and class exemption are both true to the statute and the class exemption contains the statutory findings necessary for the Department to exercise its administrative discretion to promulgate relief. This process has been careful, thoughtful, and designed to elicit the views of the entire benefits community.

The final exemption is clear, protective and administrable. Its disclosure requirements are based on, but more extensive than the basic ERISA exemptions that have been in place for more than 20 years, including PTE 77-4 for a fiduciary's use of its affiliated mutual funds, and PTE 86-128 for a fiduciary's use of its affiliated broker-dealer. In addition, unlike these earlier exemptions, the advice exemption provides an audit to the plan participant (similar to certain individual exemptions granted by the Department in recent years), and has a far more dire consequence for a pattern of noncompliance. Thus, the advice exemption, by analogy, has been proved to be administrable over time. But what is most important, these rules will, for the first time, present the realistic chance that widespread, easily accessible, person to person based professional fiduciary advice will be available and used by tens of millions of plan participants and IRA owners. We urge you not to lose sight of this goal. If professional fiduciary advice is to become the norm, we need to encourage those that are capable, trained and regulated to step forward and give this advice in a manner that makes economic sense for their employers. If we fail to do that, we may be consigning millions of Americans to "do it yourself" retirement planning.

We thank you for this opportunity to testify and I'd be happy to answer any questions you may have.

Chairman ANDREWS. Ms. Nussdorf, thank you very much. We appreciate your contribution this morning.

Ms. Grabot, welcome to the committee. And we are interested to hear what you have to say.

Ms. GRABOT. Thank you. Thank you, Chairman.

Chairman ANDREWS. I think your microphone is not on, either.

Ms. GRABOT. Oh, it should be on——

Chairman ANDREWS. There you go.

STATEMENT OF SHERRIE GRABOT, CEO, GUIDEDCHOICE

Ms. GRABOT [continuing]. But I wasn't speaking into it.

Appreciate this opportunity. GuidedChoice is one of the leading investment advisory firms, providing services to over 42,000 defined contribution plans, with more than 3.5 million participants and approximately $156 billion in assets.

The plans we service range in size from one participant to 300,000 participants. With our clients, we set up over 1,000 plans per month on our system, and we offer services through such plan providers as Merrill Lynch, Hewitt, Charles Schwab, ADP, as well as directly to plans such as Atmos Energy and McDonalds.

GuidedChoice actually began as a division and part of Trust Company of the West in 1997. As you may be aware, TCW was issued a prohibited transaction exemption, which later served as the model for the SunAmerica advisory opinion.

While there, we were conducting market research. And what we discerned from TCW's client base of over—typically the Fortune

200, we found employers wanted to provide advisory services to their employees, but were extremely concerned with an asset manager being the one to provide the advice, in spite of the relief provided by the exemption.

Given that information, along with the high cost of developing a robust system to meet the market's needs, we made the decision in June of 1999 to spin off the division. That is when I joined with Dr. Markowitz, the Nobel laureate for modern portfolio theory, to start GuidedChoice.

There are a variety of delivery models in the marketplace already. At the core of our services, our complex software tools that do enable participants to receive investment advice via the Internet, but also via phone, paper, or through face-to-face consultation that complies with both the regulatory, as well as the plan rules.

The plan administrator, plan sponsor, participant, or any combination thereof can pay for the services. Most commonly, I would say the plan administrator or the plan sponsor pays for advice services.

Most commonly, a plan administrator is an affiliate or interested party of an asset manager. We are going to comply with the SunAmerica advisory opinion.

All appear to agree that advice is a good thing for participants, and our data also support that. In our recent survey, over 92 percent of those surveyed, the participants that had used advice have indicated that they found it extremely valuable for retirement planning purposes.

In addition, our data show it is the savings rate that has the biggest implication on your retirement plan. And on average, savings rates increase 112 percent for participants using advice. So, obviously, getting advice to the majority of participants is a key factor.

But in addition, you also have an impact on investment performance that we need to be aware of. When we analyzed our database of expense ratios and quarterly returns of over 30,000 plans, we found that performance can be degraded in plans with constraints.

And what we mean by constraints is that a certain number of the investment options in the plan must be from a specified asset manager. So, for example, it is a bundled type of arrangement.

These arrangements are typically found in the small plan market, but they are creeping into the larger plan market through target date funds created by an asset manager whereby the underlying investments are a single fund family.

In recent years, plans with constraints have tended to underperform plans without any constraints between 0.25 percent and 2 percent annually. And you can see the data listed below.

In addition, the lack of knowledge regarding the risk of investment options and the associated participant behavior of investing has been the subject of numerous studies. One key finding was people's tendencies to be more sensitive to decreases in wealth than to increases in wealth. Empirical estimates found that losses were weighted approximately twice as much as gains.

So, in other words, the pain a participant experiences losing $50,000 on their $100,000 account balance is twice as painful as the pleasure they get when they gain $50,000, as we have all experienced recently.

Our experience reveals the same, which is why conventional wisdom with regard to the allocation fund of funds, target date funds, and the like may understate risk aversion for most participants.

Ninety-eight percent of advice users are invested in allocations of between 30 percent equity to 80 percent equity. Less than a half percent of advice users elect an all equity portfolio after viewing the effects of risk on return volatility.

Of those over age 50, 46 percent hold approximately 30 percent in equity and 53 percent have 25 percent or less in equity holdings. So though the allocations may be deemed conservative by industry standards, our experience with participants receiving advice is consistent with the academic studies.

The obvious impact of taking less risk to obtain the same income replacement at a chosen retirement age is increasing the savings rate. But as we see with the data cited above, most participants elect not to save the recommended amount to reach their goal, so we can extrapolate that they prefer to retire later or live off less income.

Chairman ANDREWS. Have you concluded?

Ms. GRABOT. I would say, overall, our conclusion is, you have to be careful with who is providing the investment advice. It can have an impact on returns.

[The statement of Ms. Grabot follows:]

Prepared Statement of Sherrie E. Grabot, President and CEO, GuidedChoice.com, Inc.

Thank you, Chairman Andrews, Ranking Member Kline, and members of the Subcommittee. My name is Sherrie Grabot, President and CEO of GuidedChoice.com, Inc., an independent advisory firm.

GuidedChoice.com, Inc.

GuidedChoice is one of the leading independent investment advice services firms, providing services to over 42,000 defined contribution plans with more than 3.5 million participants and approximately $156 billion in assets. The plans we service range in size from a single participant to over 300,000 participants. With our clients we set up over 1,000 plans per month on our advisory system. We offer services through plan providers such as Merrill Lynch, Hewitt, Charles Schwab, ADP, and Smith Barney as well as directly to plans such as Atmos Energy, Freescale Semiconductor and McDonalds.

A Historical Perspective

GuidedChoice began as a division of Trust Company of the West (TCW) in 1997. As you may be aware, TCW was issued a Prohibited Transaction Exemption,[1] which later served as the model for the SunAmerica Advisory Opinion.[2] While conducting market research amongst TCW's client base, which consists primarily of companies from the Fortune 200, we found employers wanted to provide advisory services to their employees but were extremely concerned with an asset manager being the one to provide the advice in spite of the relief provided by the Exemption. Given that information along with the high cost of developing a robust system to meet the market's needs, we made the decision in June 1999 to spin off the division. I joined forces with Harry Markowitz, PhD, Nobel laureate for Modern Portfolio Theory, and GuidedChoice became an independent advisory firm.

Independent Advisory Services

There are a variety of delivery models in the market. At the core of our services are complex software tools that enable participants to receive investment advice via

[1] See DOL Pension and Welfare Benefits Administration [Prohibited Transaction Exemption 97-60; Exemption Application No. D-10319]. Grant of Individual Exemptions; TCW Group, Inc., Trust Company of the West, TCW Funds Management, Inc., TCW Galileo Funds, (Collectively; TCW)

[2] See DOL Advisory Opinion 2001-09A (December 14, 2001)

the internet, phone, paper or through face-to-face consultation that complies with both the regulatory as well as the plan rules. The Plan administrator, plan sponsor, participant or any combination thereof can pay for the services. Most commonly, the plan administrator or plan sponsor pays for advice services. To avoid any conflict of interest, if a Plan administrator is an affiliate or interested party of an asset manager, we comply with the SunAmerica Advisory Opinion.

The Benefits

All appear to agree advice can benefit participants, and our data supports that. In our 2008 independent survey, 92% of participants said the advice received was extremely valuable for their retirement planning. We consider savings rate the most important aspect of retirement planning. We undertook an initial study on the retirement adequacy of future retirees of the plans who used the advice services.[3] The results made it clear that there is a significant shortfall for many participants. Participants who use our advisory services increase savings rates on average 112%. Yet the focal point of most advice and managed account services, including target date funds, is solely on the investment allocation.

Investment Performance

In analyzing our database of expense ratios and quarterly returns for over 30,000 plans, we have found performance can be degraded in plans with constraints—whereby a certain number of the investment options in the Plan must be from a specified asset manager, i.e. a bundled type of arrangement. These arrangements are typically found in the small plan market but are similar to target date funds created by an asset manager whereby the underlying investments are from a single fund family. In recent years, plans with constraints have tended to underperform plans without any constraints between 0.25% and 2.01% annually.

INVESTMENT PERFORMANCE.—VARIANCE BETWEEN UNRESTRICTED AND RESTRICTED PLANS

[For the period 1/1/2005 to 12/31/2008]

Cash 69% Bond 22% Equity 9%	Cash 36% Bond 42% Equity 22%	Cash 5% Bond 63% Equity 32%	Cash 0% Bond 51% Equity 49%	Cash 0% Bond 34% Equity 66%	Cash 0% Bond 17% Equity 83%	Cash 0% Bond 0% Equity 100%
0.58%	0.45%	0.25%	0.34%	0.30%	0.34%	2.01%

Source: GuidedChoice.com, Inc. database of plan investment options. Data calculated by optimizing plan investments to selected points on the efficient frontier, then calculating an annualized weighted return based on the investment options' underlying performance. Investment performance of plans without restrictions on investment options is compared to that of plans with restrictions.

Risk Level Selection

The lack of knowledge regarding the risk of investment options and the associated participant behavior of investing has been the subject of numerous studies.[4] One key finding was people's tendencies to be more sensitive to decreases in wealth than to increases in wealth. Empirical estimates found that losses were weighted approximately twice as much as gains.[5,6] In other words, the pain a participant experiences losing $50,000 on a $100,000 account is roughly twice the pleasure of gaining $50,000. Our experience reveals the same, which is why conventional wisdom with regard to the allocation of fund of funds, target date funds and the like may understate risk aversion.

Ninety eight percent of advice users are invested in allocations of between 30% equity to 80% equity. Fewer than a half percent of advice users elect an all equity portfolio after viewing the effects of risk on return volatility. Of those over age 50, forty six percent hold approximately 30% in equity and fifty three percent have 25% or less in equity holdings. Though the allocations may be deemed conservative by industry standards, our experience with participants receiving advice is consistent with the academic studies. The obvious impact of taking less risk to obtain the same income replacement at a chosen retirement age is increasing the savings rate. Since the data cited above indicates most participants elect not to save the recommended

[3] This study undertaken in 2004 included 25,000 401(k) plan participants. Participants were encouraged to enter in assets that were not employer related, including spousal plan assets, previous employer plan assets, Individual Retirement Accounts, annuities and any other assets held for retirement purposes. On average, the recommendation to participants was to increase savings rates by 258%. The data revealed that those covered under a pension plan and lower-wage workers, for whom Social Security provided a higher income replacement ratio, fared far better. For those covered by a pension plan, the average required increase to savings rates was 38%.

[4] See Bernartzi and Thaler (2001)

[5] See Tversky and Kahneman (1992)

amount to reach their goal, we can extrapolate that they prefer to retire later or live off less income.

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Chairman ANDREWS. Thank you very much, Ms. Grabot. We appreciate your testimony and your contribution this morning.

Mr. Oringer, welcome to the Committee.

STATEMENT OF ANDREW L. ORINGER, PARTNER, WHITE AND CASE

Mr. ORINGER. Thank you so much. It is a real honor and privilege for me to speak here today.

I start with a problem. Maybe the most important investment capital in this country is in the hands of the people least qualified to invest it.

Now, how did we get here? The result of well-meaning regulation was a flight from defined benefit plans to individual account plans and a shift of investment risk to the employee. Then came section 401(k), and also various encouraged participant-directed investments. Participants favored this path, especially during the Internet boom.

Well, the bubble soon burst, but there was no way to turn back this clock, with the result that retirement assets came to be managed by those least capable of managing them.

When employers and advisers tried to provide advice, they often were discouraged by ERISA's fiduciary rules. Now, I have long felt that the inability of participants to get personal investment advice is one of the greatest problems with our retirement system.

An emerging question: Why not allow the advice only if it is conflict-free? Well, because you may want a wider choice available regarding this critical advice, and some permissible structures may not make business sense.

Maybe the right answer here is what I would call conflict-safe. I would think that we want not only to protect, but also to help. What good is it if participants are protected regarding services that no one is willing to provide?

Now, one could wonder, in light of applicable securities regulation, whether there is any need at all for additional ERISA protection. This approach, however, would ignore the special ERISA considerations relating to conflicts.

And so what is it that makes the retirement context so special that would justify an additional overlay of ERISA regulation on top of securities regulation? I would suggest that the ERISA context does justify inquiry, such as the one taking place here today, but I would also suggest that it does not support a complete lack of faith in the entire financial industry.

I do not think that concerns about conflicted advice should lead to concluding that inside advice can never feasibly be permitted. I would also submit that the discourse could benefit from a neutral term, like "inside advice," rather than the more pejorative "conflicted advice."

And now let's look at Labor's fee-leveling regulations. One key aspect relates to identifying the parties whose fees need to be leveled. The individual adviser would be required to be insulated as to his or her own compensation.

Indeed, though, if you were to take leveling too high up the chain so that the fees to the institution as a whole are unaffected by the advice, you start not to need the exemption at all, as you may be eliminating the conflict altogether.

Now, at this point, I just want to take a moment to talk about the regulatory process. And I think that the Department tried to craft rules that implement Congress's wishes in a workable way. I know there has been some rhetoric regarding bias, but my experience with Labor personnel has been that they are highly focused on protecting participants and beneficiaries, indeed, often to the significant consternation of employers and financial institutions.

Now, I can understand that any given compromise or balance struck by lawmakers and regulators this far is not necessarily perfect and that Wall Street is in the crosshairs right now. Nevertheless, I think that it is critical to address the issues by contemplative attention to the various competing policy considerations.

If the effective regulation, however well-meaning, is to bar or discourage desired services, then the regulation may fail to achieve its true goal. Whatever you may think about the present rules, I see efforts like those you are making here today as hopefully leading to the right balance between workability and safeguards, neither one being to the exclusion of the other.

I do think that participants and employers alike are crying out for readily available, personalized, tailored, non-mechanical advice from expert professionals that know and understand the participants and their plans.

If we ultimately come out—if where we ultimately come out is that only the use of true third parties is sufficiently safe, well, then so be it. The outside third party may be more insulated from conflicts of interest than an inside provider. I think that the price of that course, however, is giving up the benefit of having the largest institutions with the greatest resources be viable options for the provision of this advice often at low or no cost.

I certainly would tell a client that the third-party route is a viable and excellent choice. My point is just that the employer should also be free to choose the efficiencies and benefits that could come with the use of a player already involved with the plan or its investments.

In closing, I would submit that the ERISA fiduciary context does not justify abandoning the securities regulation that governs the advisory community, but rather should inform a contouring of additional ERISA rules to the special circumstances applicable to plan participants.

If the utility of a broad range of available advice is accepted, then the holy grail here should not be the delivery of purely conflict-free advice. It should be the delivery of conflict-safe advice.

We are not going to be able to turn back the clock on individual accounts and participant direction, so, at the end of the day, the greatest risk here may well be that the system fails to figure out a way to allow for the delivery of the best advice to those who need it most.

And I see that the red light is on, so, with apologies to Chairman Andrews, I will not have time to talk about Duke-Villanova. And thank you very much.

[The statement of Mr. Oringer follows:]

Prepared Statement of Andrew L. Oringer, Partner, White and Case

It is an honor for me to have been asked to speak today, and it is my privilege to be here. I am here personally, not on behalf of my firm or any client.

I start on this topic from the perspective that there is a problem. The problem is that maybe the most important investment capital in this country—assets in participant-directed 401k plans—is in the hands of the people least qualified to invest that money—rank-and-file plan participants. One need only look at my own not-so-stellar stock picks, if you want to use me as an example.

I'd like to take a step back and spend a moment reviewing the evolution of the system and how we got to where we are. Initially, defined benefit plans, with their promised benefit and with investment risk on the employer, were the cornerstone of our retirement policy. Congress understandably upped the ante on the regulation of defined benefit plans, in an effort to protect the pension promise and take some of the heat off of the Federal insurance program. Funding rules tightened, administrative and other expenses increased, and the rules relating to liability for plan underfunding were substantially tightened. The result of this well-meaning regulatory evolution was a flight from defined benefit plans to individual account plans, and a shift of investment risk to the employee.

Two other things then happened. One was Congress's approval around 1980 of a system of tax-advantaged elective deferrals—401(k) plans. Essentially, the Treasury became a partner in the provision of employee benefits, as all of the cost of the salary deferrals came from the employee, and yet the benefit to the employee came not from the employer but from the benefits of tax deferral. Employers could supplement this benefit with profit sharing and matching contributions, but the heart of the system became the employee's own elective deferral.

At about the same time, practice, technology, and the law fostered a trend to participant-directed investments. Participants, particularly younger participants more focused on the here-and-now, liked this trend for the control it gave them, particularly in the context of a plan that, with its relatively straightforward account statements and easily understood account balances, was generally more appealing to the average participant than the defined benefit plan. This trend was fueled by the perception during the internet boom that the accounts could only go up. The question wasn't whether the accounts would grow; the question was high they would go.

Then, the internet bubble burst, and there became a lot more focus on the abject lack of capacity that people had to manage these critical assets. But there was no way to turn back this clock. Defined benefit plans were essentially gone, and defined contribution plans were with us to stay * * * with the result that this critical portion of the biggest lump of money in the world—as retirement assets have been called—came to be managed by those least capable of managing it.

When employers and financial institutions moved to provide real advice to participants, they immediately became faced with ERISA's fiduciary standards, which have been referred to as being among the highest known to the law. The general self-dealing rules are extremely inflexible, as they should be, and neither notice nor fairness is enough to cleanse justify prohibited conflicts of interest. As a result, many advisory services available in the market cannot feasibly be provided in connection with an ERISA plan. In addition, some employers have been concerned under the general prudence rules that arranging for advice, if not under a type of program affirmatively endorsed by Congress or Labor, could be risky.

Thus, ERISA has had the general effect of discouraging financial institutions from providing advice to participants and of discouraging some employers from arranging for advice even when it is available in the market. When the employer has been willing to make the move, frequently, under ERISA's legal framework, the only feasible alternative from the plan's existing providers has been computer-driven model-type advice, rather than true personalized advice.

I've felt for some time that the inability of participants to get employer-facilitated investment advice of the type that other investors can get is one of the greatest problems with our retirement system. I think it's pretty clear that employees want this advice, and that employers want them to have it.

An emerging question is: why shouldn't we let ERISA's general rules continue to bar the advice if there is a conflict? In effect, why not allow the advice only if it's conflict-free? Well, because you may want the widest range of expert personnel providing this critical advice, and at some point, at least in the case of advisers already involved with the plan or its investments, the only permissible structures may not make business sense. ERISA is chock full of legislative and administrative exceptions to its general rules, where there is a judgment that policy considerations justify divergence from general principles, and where safeguards are viewed as striking the proper balance. That it can be shown that a particular course requires some divergence from general principles does not provide a final answer—if it did, there would be no exceptions whatsoever. Maybe the right answer here is what I'll call "conflict-safe," rather than conflict-free.

Put another way, we want not only to protect participants but also to help them, and you don't always want to tilt everything towards one side of the coin. Many of ERISA's fiduciary rules are designed to balance protection with approaches that make business sense, so that players in the market are incentivized to remain players in the market and to provide needed services. What good is it if participants are protected regarding services which no one is willing to provide? In this case, I think, you want to encourage the provision of the advice, but with adequate safeguards.

On one extreme, it could be argued that, since advisers are otherwise regulated, there is no need for any additional gloss under ERISA. This approach, however, would ignore that the role of the advice is in connection with retirement plans, and that special considerations, essentially growing out of ERISA's concerns regarding conflicts, may arise.

So, what is it that makes the retirement context so special, that would justify an additional overlay of ERISA regulation? An understanding of that question could lead to an understanding of where a proper balance can be struck. Is it because of the rank-and-file nature of the participant base? Is it because of the fiduciary component of ERISA money management? Is it because of the peculiarly long-term nature of the presumptive investment strategy for retirement assets? Well, maybe all of this and more indeed justify special ERISA rules and regulations for advisers in this area. But does it justify a total lack of trust for an industry that generally is otherwise intensely regulated?

I would suggest that the ERISA context justifies inquiry such as the one taking place here today, but does not support a complete lack of faith in the entire industry. On balance, I think that the issue of conflicted advice, as it's come to be called, is a substantial one. It is one that needs to be addressed before anyone gets comfortable that an exception to ERISA's well-crafted fiduciary rules is appropriate. I do not think, however, that concerns about conflicted advice should lead to the conclusion that inside advice—advice provided by one already providing services to the plan or with respect to its investments—can never feasibly be permitted. Indeed, I think that the tone of the discourse would benefit from the use of a more neutral term like "inside advice," as compared with the more pejorative "conflicted advice."

Let's look at what we presently have under the approach in Labor's fee-leveling regulations. One key aspect of the analysis relates to identifying the parties whose fees need to be leveled. The Department looked at the statutory language and concluded that the requirement applies at the adviser level. I thought that, here, a good and thoughtful balance was struck by Congress in the PPA, as interpreted by the Department. The idea is that the individual adviser would be required to be insulated from the perspective of his or her own compensation, while the regulated entity would be trusted, if you will, to conduct itself appropriately. The hope, then, was that fee-based incentives at the institutional level would not be enough to cause the individual to skew the advice. I came to believe that this balance made sense, if we were going to want these institutions to bring their expertise to bear on helping participants. Indeed, if you take the fee-leveling requirement too high up the chain, so that the fees to the institution as a whole are unaffected by the advice, you start not to need the exemption at all, as you will come close to eliminating the conflict altogether.

My take on the separate class exemptions in the regulations, the ones that go beyond what is specified in the statute, is that Labor personnel wanted to craft these exemptions not to allow abuse, but to refine Congress's work consistently with the parameters and principles that Congress laid out. I don't think I'm being naive here in describing the Department's approach. I again, believe that the Department wanted to facilitate the delivery of true and useful advice consistently with congressional intent.

At this point, I just want to say a word or two about my perception of the regulatory process that led to the final rules. I think that the Department looked carefully at the statute and tried to craft rules that implemented Congress's wishes in a workable way. I know there has been some rhetoric regarding a slant in favor of the financial institutions, but my experience with Labor personnel—from the top to the bottom—has been that they are highly focused on protecting participants and beneficiaries, often to the significant consternation of employers and financial institutions. Indeed, a number of what I would characterize as strained interpretations are interpretations that slant substantially against—not towards—employers and financial institutions. But that is what they felt they needed to do, in order to do the right thing. Here, the Department was faced with Congress's groundbreaking attempt to make meaningful investment advice broadly available. Implementation of the new rules was presumably to the benefit of participants, and so the question became: how best to implement?

I can understand that any given compromise or balance struck by lawmakers and regulators thus far is not necessarily the perfect one. I can also understand that Wall St. and the prior administration are in the cross-hairs right now. But if there are shortcomings in the rules than let's address them—shortcomings don't mean that the motives of the regulators were inappropriate. Nevertheless, I think that it is critical to address the issues by attention to the various competing policy considerations and by a focus on the manner in which the various rules fit together, so that decisions now can be made in the contemplative way that these important issues deserve. Ultimately, if we can permit the provision of well-intentioned professional advice in an appropriately safeguarded way, we will have done well for the participants we are trying to help and protect. If we're going to conclude that we simply cannot find a way to permit this needed advice to be delivered, well that, I think, would be unfortunate. If the effect of regulation, however well-meaning, is to bar or disincentivize desired conduct and services, then the regulation may failure to achieve its true goal.

Regardless of what you may think about the present rules, I see efforts like those you are making here today as hopefully leading to workable exceptions that strike the right balance. If we agree that this advice should be available, than workability needs to be a paramount consideration. The key to me is finding the balance between workability and safeguards neither one being to the exclusion of the other.

If we're now going to decide that Congress or the Department may not have gotten it exactly right, I hope that we wind up with a set of rules that encourage the provision of advice with proper safeguards. One thought I had was to encourage the adviser to present alternative investment strategies with increased levels of conservatism, together with an explanation of the potential value of conservatism. In any event, I agree that we don't want rules that are used, if they're susceptible to being used in an abusive way. Likewise, though, if we wind up with rules that are safe but unused, we haven't addressed the crying need that we have today. And I do think that participants and employers alike are crying out for readily available, personalized, tailored, non-mechanical advice from expert professionals that know and understand the participants and their plans.

Arguably, to be sure, the outside third party is more insulated from conflicts of interest than an inside provider would be. But that is the beginning of the inquiry, not the end of it. The questions then become: is there value to permitting the provision of inside advice, and are the restrictions that surround the inside provider sufficient? I think that an advantage of doing so would be to permit the efficient use of expert advisers who may already be familiar with the plan and its investments, and who may be willing to provide the advice on a low-or no-cost basis as a part of the services generally being offered. Thus, if the inside adviser is used, you get the efficiencies that come with not having to bring in third parties. The use of inside advice could give rise to efficiencies from operational and cost perspectives; there could be ease of integration and communication. Having said that, an employer would of course always be free to arrange for the use of an outside third party, and make use of that more insulated expertise, if it were to be decided that such a choice were best for the plan.

If where we ultimately come out is that only the use of true third parties not otherwise involved with the plans is sufficiently safe, then so be it. I think that the cost of that determination, however, is that you would be giving up the benefit of having the largest institutions with the greatest resources be viable options for the provision of this advice. It is now evident that there will always be a valuable role for the independent third parties that have so capably jumped into this breach, and I certainly would tell a client that the third-party route is a viable and excellent choice. My point is just that the employer should also be free to choose the efficiencies and other benefits that could come with the use of a player already involved with the plan or its investments, if a reasonably safe way can be found to permit the employer to make that choice.

In closing, I would submit that the ERISA fiduciary context does not justify a wholesale abandonment of the securities regulation that governs the advisory community, but rather should inform a contouring of additional ERISA rules to the special circumstances applicable to plan participants and beneficiaries. Thus, if the importance and utility of a broad range of available advice is accepted, the Holy Grail here should not be the delivery of purely conflict-free advice—it should be the delivery of conflict-safe advice. At the end of the day, I think that it's critical that a broad range of effective advice be made available to participants and beneficiaries. We're not going to be able to turn back the clock on individual accounts and participant direction. To me, the greatest risk here is that the system fails to figure out a way to allow for the delivery of the best advice to those who need it most.

Thank you.

Chairman ANDREWS. We all know who is going to win anyway. It is not Duke, but——

[Laughter.]

Mr. ORINGER. No comment.

Chairman ANDREWS. That is a wise choice.

Thank you very much. We find your testimony very helpful, and we look forward to asking questions.

Mr. Baker, welcome to the Committee.

STATEMENT OF KEN BAKER, CORPORATE DIRECTOR OF HUMAN RESOURCES, APPLIED EXTRUSION TECHNOLOGIES

Mr. BAKER. Thank you, Mr. Chairman and members of the Subcommittee.

Applied Extrusion Technologies, AET, is the largest producer of oriented polypropylene films in North America. Our films are used in hundreds of packaging and labeling applications. We produce most of the Coke bottles and, I am glad to say, this film here on these little bottles.

In the United States, AET has 620 employees; most of them are located in a large manufacturing site in Terre Haute, Indiana. Shop floor employees make up nearly 66 percent of the total employment.

Our 401(k) has been a very important benefit to our company and to our employees. We have a plan investment committee which reviews the benefit structure and investment options on a regular basis.

We previously engaged in commissioned investment adviser at Morgan Stanley, who then brought us to Fidelity to be our 401(k) plan provider. In this capacity, the adviser and Fidelity provided the investment options, advised us on the options, and administered the plan.

Over time, we began to feel uneasy about the close relationship between the adviser and Fidelity. It was difficult to understand this arrangement and the associated fees. It felt like the adviser was working for Fidelity and not for us.

In 2006, the committee attended a 401(k) conference. It became apparent, to be more responsible fiduciaries, we should seek out an investment adviser.

CapTrust out of Raleigh, North Carolina, was selected as the new plan adviser. We now have an independent advocate that asks the right questions about fund performance and fees. We also appreciate the adviser's encouragement to continually improve the 401(k) plan experience for our employees.

After the first meeting with CapTrust, the committee moved to significantly revise the plan investment options. We went from retail funds to institutional funds that have shown to be better performers with lower transparent fees.

The new adviser regularly holds one-on-one and group employee meetings. Even though employees see the adviser fees, they do not object, because they see the value.

The guidance provided to the plan investment committee by our new independent adviser has made an enormous difference. Here are some compelling statistics.

The participation rate has increased from 79 percent to 96 percent. The average deferral rate for employees has increased from 4 percent to 7 percent. The company match is now contributed at the end of each month, as opposed to the end of the year. Employees are now fully vested after 2 years instead of 5 years. We now automatically enroll all employees not participating.

I am convinced that, despite the market declines, the investment performance of the plan is much better than it would have been. Despite the bad economy and much lower 401(k) account balances, AET's 401(k) plan stands tall. The transparency of the independent adviser and fund fees has been a big deal.

In 2009, the automatic deferral increase went up by 1 percent. No one waived out, despite what is going on in the market.

AET has always offered a 401(k) plan to help employees prepare for retirement. Going forward, we will continue to use CapTrust and Fidelity to regularly educate our employees.

I am here to make sure you understand how important it is to have an independent investment adviser involved with the plan. I understand that recent DOL regulations would have made it easier for the advisers with a conflict to offer their services to plan sponsors.

That is not, in my opinion, the direction we should be taking. Instead, we should be making it easier for plan sponsors to engage in independent advisers like ours.

Thank you for this opportunity. I would be happy to answer any questions.

[The statement of Mr. Baker follows:]

Prepared Statement of Ken Baker, Corporate Director of Human Resources, Applied Extrusion Technologies (AET)

Thank you, Mr. Chairman and members of the subcommittee. I am Ken Baker, the Corporate Director of Human Resources for Applied Extrusion Technologies (AET). My Company is the largest producer of oriented polypropylene films in North America. Our films are used in hundreds of packaging and labeling applications. For example, we produce most of the labels used on Coke bottles.

In the United States, AET has 620 employees; most of them are located at a large manufacturing site in Terre Haute, Indiana. Shop floor employees make up nearly 66% of the total employment.

Our 401(k) Plan has always been very important to our Company and our employees. We have a Plan Investment Committee which reviews the benefit structure and investment options.

We previously engaged a commissioned Investment Advisor at Wachovia who brought us to Fidelity to be our 401(k) Plan Provider. In this capacity, the Advisor and Fidelity provided the investment options, advised us on the options, and administered the Plan.

Over time we began to feel uneasy about the close relationship between the Advisor and Fidelity. It was difficult to understand this arrangement and the associated fees. It felt like the Advisor was working for Fidelity and not for us.

In 2006 the Committee attended a 401(k) conference. It became apparent to be more responsible fiduciaries, we should seek out an Independent Advisor.

CapTrust out of Raleigh, NC was selected as the new Plan Advisor. We now have an independent advocate that asks the right questions about fund performance and fees. We also appreciate the Advisor's encouragement to continually improve the 401(k) Plan experience for our employees.

The employees now know the Advisor fees. After the first meeting with CapTrust, the Committee moved to significantly revise the Plan investment options. We went from retail funds to institutional funds that have shown to be better performers with lower, transparent fees. The new Advisor regularly holds one on one and group employee meetings. Even though employees see the Advisor fees, they do not object because they see the value.

The guidance provided to the Plan Investment Committee by our new independent Advisor has made an enormous difference. Here are some compelling statistics:

- The participation rate has increased from 79 percent to 96 percent;
- The average deferral rate for employees has increased from 4 percent to 7 percent;
- The company match is now contributed at the end of each month as opposed to the end of the year;
- Employees are now fully vested after 2 years instead of 5 years;
- We now automatically enroll all employees not participating;
- Fees are now transparent and lower than what we were previously paying; and
- I am convinced that despite the market declines, the investment performance of the Plan is much better than it would have been.

Despite the bad economy and much lower 401(k) account balances, AET's 401(k) Plan stands tall. The transparency of the independent Advisor and Fund fees has been a big deal. In 2009, the automatic deferral rate was increased by 1%. No one waived out, despite what is going on in the market.

AET has always offered a 401(k) plan to help employees prepare for retirement. Going forward we will continue to use CapTrust and Fidelity to regularly educate our employees.

I am here is to make sure you understand how important it is to have an independent Investment Advisor involved with the Plan. I understand that recent DOL regulations would have made it easier for Advisors with a conflict to offer their services to Plan Sponsors. That is not, in my opinion, the direction we should be taking. Instead we should be making it easier for Plan Sponsors to engage independent Advisors like ours.

Thank you for this opportunity. I would be happy to answer any questions.

Chairman ANDREWS. Thank you very much, Mr. Baker. It is good to hear the story of your company and the success that you are having. We are glad that we are using your product. That is a happy coincidence this morning. I wish we could take credit for that.

Dr. Jeszeck, before you testify, I think I speak for both the ranking member and myself that we very much value you and your colleagues at the GAO. On a wide variety of issues, you call them as you see them. You do very thorough, careful work, and we very much appreciate the contribution you and your colleagues make.

STATEMENT OF CHARLES A. JESZECK, ASSISTANT DIRECTOR FOR EDUCATION, WORKFORCE AND INCOME SECURITY ISSUES, GOVERNMENT ACCOUNTABILITY OFFICE (GAO)

Mr. JESZECK. Mr. Chairman and Members of the Committee, I am pleased to be here today to speak about how undisclosed conflicts of interest can affect the financial performance of retirement plans.

Because our nation's economic turmoil is threatening the retirement hopes of so many Americans today, this hearing is both timely and crucial. My testimony will review the findings of our 2007 study that explored the association between undisclosed conflicts of interest involving pension consultants and the rates of return of defined benefit pension plans.

I will also discuss some vulnerabilities conflicts of interest may pose for self-directed plans, like 401(k) plans.

These issues are important because conflicts of interest have the potential to erode investor confidence and reduce the incomes Americans will depend upon in retirement. A conflict of interest typically exists when someone in a position of trust, such as a pension consultant, has competing professional or personal interests. Such conflicts can take many forms.

No complete information exists about the presence of conflicts of interest involving pension plan service providers. However, a 2005 SEC examination of the activities of 24 pension consultants found that 13 had failed to disclose ongoing conflicts of interest.

Using this data, GAO employed a variety of statistical techniques to tease out the possible relationship that such conflicts of interest could have on the annual rates of return of related defined benefit plans.

In sum, controlling for a variety of economic and other factors, we found lower annual rates of return for those ongoing plans associated with consultants that had failed to disclose significant conflicts of interest. Specifically, these lower rates ranged from a statistically significant 1.2 to 1.3 percentage points over the 2000 to 2004 period we examined.

Since the average annual return for ongoing plans that use consultants who did not have significant violations was about 4.5 percent, our results suggest that the average annual return for plans that use consultants with conflicts was 3.2 percent to 3.3 percent.

Although GAO's results suggest a negative association between returns and plans that worked exclusively with pension consultants with conflicts, they should not be viewed necessarily as evidence of a causal relationship. While GAO's analysis controlled for many key variables, it is possible that other unknown factors could be at play, influencing our results.

In addition, while our results give an indication of the potential harm conflicts of interest may cause in the aggregate, they cannot be generalized to all pension consultants, since the ones reviewed in the SEC study were not chosen randomly.

It is also important to keep in mind that, financially costly as conflicts of interest might be in the defined benefit world context, their risk is largely borne by the plan sponsor and not the participant. In most instances, the sponsor is responsible for funding the benefits promised to D.B. plan participants regardless of the fund's investment performance.

While our study focused on D.B. plans, conflicts of interest can have more direct consequences for participant of defined contribution plans. This is because, under a typical self-directed plan, investment risk is largely borne by the individual participant. Lower rates of return directly affect the participant's account balance and, everything else equal, will lead to lower accumulated savings over a worker's lifetime.

Thus, participants are vulnerable to any situation or decision, including those involving conflicts of interest, that could result in higher fees or charges that could lead to lower investment returns.

Although we have no complete information on the extent of conflicts of interest or their effect on D.C. plans, we know that the potential for them exists. For example, we found in past work that some plan sponsors may be unaware that the service providers who assist them in selecting investment options may also be receiving compensation from mutual fund companies for recommending their funds, creating a situation of competing professional interests.

The Labor Department has proposed regulations that seek to expand the information it has on business arrangements among service providers. These regulations are pending review by the Secretary of Labor. GAO has not formally reviewed these regulations. However, properly designed, they could provide greater disclosure regarding potential conflicts of interest.

Improved disclosure of potential conflicts of interest can be a small, but important step in restoring investor confidence in our financial markets and institutions, as well as protecting the increasingly fragile retirement security of American workers.

That concludes my statement, Mr. Chairman. I am available for questions.

[The statement of Mr. Jeszeck may be accessed at the following Internet address:]

http://www.gao.gov/new.items/d09503t.pdf

Chairman ANDREWS. Dr. Jeszeck, thank you very much for your contribution, the very solid work you have done in this area over all these years.

Mr. JESZECK. Thank you, sir.

Chairman ANDREWS. I think we have had an outstanding panel this morning. Thank you to each of you for the contribution you have made. And we will now begin with questioning.

Dr. Jeszeck, one of the conflicts that I think the report from 2007 describes is that some of the pension consulting firms had software programs that they sold either directly or through an affiliate, and some of their buyers were money management firms. Is that correct?

Mr. JESZECK. I believe—yes, sir.

Chairman ANDREWS. So the potential conflict here was that, on one hand, the pension consulting firm could be giving advice to a board of trustees to invest in that money management firm. On the other hand, they could be selling a product to that money management firm. Is that correct?

Mr. JESZECK. Yes, sir.

Chairman ANDREWS. And if I understand correctly, the association that you point out—I know you don't say "causation"—but there is an association that the defined benefit boards of trustees that exclusively use these 13 pension consultant firms that had these kinds of conflict of interest that you label as significant in the report, that if you look at the rate of returns from 2000 to 2004, the firms that did not use these consulting firms with the conflicts had a rate of return of 4.5 percent, and the firms that did use these conflicted consultants had a rate of return of 3.2 percent. Is that essentially right?

Mr. JESZECK. Yes, sir.

Chairman ANDREWS. Okay.

Now, Mr. Oringer, you have suggested that we sort of change the name from conflicted advice to inside advice. And I understand the point of your testimony. But isn't that just a semantic difference that would just call the existing conflict by a different name?

I understand this is in the defined benefit context, the questions I am raising, although I think you would agree that, generally speaking, defined benefit boards of trustees are better equipped to sniff out these conflicts than individual D.C. plan participants.

So aren't you really just suggesting, you know, giving the problem a different name, rather than solving it?

Mr. ORINGER. There is no doubt that it is a semantic difference. I guess my point would be looking at it from the other direction, that to me the use of the phrase "conflicted advice" tilts it in a pejorative way and casts aspersions on it just by the way of referring to it——

Chairman ANDREWS. Do you agree that the fact pattern I outline is a true conflict of interest, where if the firm is selling software on the one hand and recommending placing money—do you think that is a conflict of interest?

Mr. ORINGER. I think that any given conflict and the fact that—and there may well be conflicts—has to be analyzed to see how dangerous that conflict may or may not be. ERISA has exceptions running all through it.

Chairman ANDREWS. But do you think the conflict I outline here is a dangerous one?

Mr. ORINGER. I think the conflict is one that needs to be focused upon. I do not think that you could turn your head away from the conflict without addressing it, considering it, and seeing whether or not it poses undue risk.

Chairman ANDREWS. Now, Ms. Grabot talked about—if I read your testimony correctly—that in the plans that you have taken a look at, that plans that you call plans that have constraints—and I think you mean by constraints that there is an advisory that limits the number of choices than an enrollee can make. Is that what you mean by constraints?

Ms. GRABOT. Not necessarily. Really, what a constraint would be would be that you have to have so many funds from a particular fund family.

Chairman ANDREWS. Okay.

Ms. GRABOT. So, especially in the small plan market——

Chairman ANDREWS. So it is steering the money toward a given place to invest the money, correct?

Ms. GRABOT. Absolutely.

Chairman ANDREWS. Favoring that——

Ms. GRABOT. Yes.

Chairman ANDREWS. Favoring that outcome.

Ms. GRABOT. But typically there is a good reason for that.

Chairman ANDREWS. And you said that the plans without constraints tend to—excuse me, the plans with constraints underperform the plans without them by anywhere from 25 to 201 basis points. Is that your conclusion?

Ms. GRABOT. Right. That was from 2005 to 2008.

Chairman ANDREWS. Mr. Oringer, I mean, you have suggested that the phrase "conflict-safe"—would that be a safe conflict or an unsafe conflict, by your definition?

Mr. ORINGER. Well, again, I think that you need to look at the situation. You have to draw balances. You have to come to a resting place where you are comfortable, that a particular conflict is one that can both be understood by the people using the service and one that, even if it is understood doesn't have an undue risk of self-interest.

Chairman ANDREWS. We are just hoping the resting place isn't in bankruptcy court, as it has been for so many people.

Well, let me say this. I think you have made a very important contribution in pointing out that no one is truly independent if they are in this marketplace. No one is completely and truly independent.

But I think you would agree that there are gradations of association that, if you have one set of clients you are selling software to and another set of clients you are giving advice to, that there is a greater risk of conflict than normal.

Would you agree with that?

Mr. ORINGER. I do agree. And I agree that there could come a point at which you would conclude that a particular conflict cannot be permitted to continue.

Chairman ANDREWS. Well, I see—I am sorry. Finish, and my time is expired, and I want to go——

Mr. ORINGER. No, no, no, I was only going to say that it doesn't mean that every conflict falls into that basket.

Chairman ANDREWS. I hear you. And I appreciate all the witnesses.

Mr. Kline is recognized for 5 minutes.

Mr. KLINE. Thank you, Mr. Chairman.

I would like to add my thanks to yours for the witnesses and my admiration. This is a terrific panel. It is really a panel of experts. We are always looking for these. Sometimes we make it; sometimes we don't, frankly. But it is a terrific panel.

Chairman ANDREWS. We always do.

Mr. KLINE. An enormous amount. Well, I am not sure. Was that too many lawyers on the panel? I forgot. Duke-Villanova. Okay. It is going to be Duke.

Chairman ANDREWS. The gentleman's time is expired. [Laughter.]

Mr. KLINE. All right, I am eating up my time here. I know better than this.

A couple of things, Ms. Grabot. You sort of were cut off, not intentionally, as you were finishing a thought. And I am just interested to hear what you had to say when you mentioned there are good reasons for steering or having some smaller plans. Could you expand on that and just tell me what that meant?

Ms. GRABOT. Well, typically, what you have in the small plan market especially is that the asset management fees that are collected from the asset managers are offsetting the recordkeeping fees. And so, rather than either the small plan employer or the participants directly paying the recordkeeping fees, they are indirectly paying through the asset management.

Now, whether that is, you know, a good thing or bad thing depends on the math. And so that comes down to all of your fee disclosure. In the past, as we heard Mr. Baker testify, in some instances, it was very difficult to get at that fee disclosure.

So, again, it comes down to, yes, disclosure is good, but keep in mind, too, participants are overwhelmed right now with disclosure. So it becomes very difficult to discern where it is good and where it isn't.

Mr. KLINE. Okay, thank you. I just—I knew you were going somewhere, and I wanted to give you the opportunity to complete that thought.

I am a little bit confused here about where we are in terms of what you can and cannot do now, today, in terms of independent advice. Mr. Baker talked about going from—Fidelity, I believe, was providing it to an independent adviser. Now, it is clearly before we got the rule coming out of the Pension Protection Act, because you have been able to gather this.

So let me turn—rather than you, Mr. Baker, let me go to Ms. Nussdorf and ask you, can you explain to us what the rules are now, pre-rulemaking, as far as getting independent advice for plan participants, I am talking about, and what they would be following the rulemaking?

Ms. NUSSDORF. Absolutely.

Mr. KLINE. Thank you.

Ms. NUSSDORF. Prior to the Pension Protection Act, an independent adviser whose affiliates don't sell any product had the regular services exemption to provide an exemption for the prohibited transaction of a party in interest providing services to the plan.

So nothing else was needed. The Pension Protection Act was not needed for that person. And there was no conflict of any sort, except obviously with respect to people who were not complying with the law or other laws.

So we didn't need the Pension Protection Act for that. What we need the Pension Protection Act for is to increase the number of people able to give advice, to try to get more advice to plan participants. And I think we can't forget that, as people retire, their money is going into IRAs. Those people don't have a plan sponsor to look to.

And so what the department tried to do was provide enough disclosure—the audit, the description of fees, the description of material conflicts—so that an average plan participant—you and me—could fully understand what the choices are.

And in the end, that is the ball I think we have to keep our eye on: What are we going to do about all those IRA participants? And how are they going to get enough advice so that they feel secure?

Mr. KLINE. I thank you. Let me just kind of let you develop that thought for just a second here by just cutting right to the chase.

If Congress required that investment advice be provided only by independent providers, what effect would that have?

Ms. NUSSDORF. Well, you would have prior to the Pension Protection Act, a small percentage of IRA owners and plan participants getting advice. It is not that the advice that they were getting before was bad. It is great. It is just that it is not widespread enough.

And in the end, you need to decide whether or not you want participants and IRA owners to get advice on a broad scale in a way that is comfortable for them.

Mr. KLINE. So there would be less advice, not more?

Ms. NUSSDORF. Yes, that is the concern. If they wanted advice from an independent source, they could have had that since 1975.

Mr. KLINE. Okay. Thank you very much.

Mr. Chairman, I yield back.

Chairman ANDREWS. I thank my friend.

And we turn to the gentleman from Illinois, Mr. Hare, for 5 minutes.

Mr. HARE. Thank you, Mr. Chairman.

Ms. Nussdorf, I appreciate the concern that you bring up about the danger of limiting the number of investment counselor advisers, since there are not enough advisers in the market now.

However, my question is, if we do not require consultants to be free of affiliation or other conflicts, how do we protect the investors or help them make the decisions for themselves, especially in light of the evidence that those who receive advice free of conflicts seem to be getting higher rates of return?

Ms. NUSSDORF. Congressman Hare, I am not a statistician, and I can't judge whether or not the statistics that have been given this morning are, in fact, completely correct.

But I do think that the Department has struggled and Congress has struggled since 1975 to deal with the issue of conflicts. And since 1975, an investment manager can use his own mutual funds, which is clearly a conflict, under terms of an exemption that provide for advanced disclosure, written consent, an offset of duplicate fees.

So it is a balancing act. In the end, you need an exemption and a regulation that clearly focus on the conflicts and try to deal with as many ways to protect participants against those conflicts as you can.

So I would tell you, six or seven different points in the regs in the class exemption try to deal with that conflict. Is it perfect? I think it is really, really good. Is there a possibility that there could be a problem? Sure, there is always a possibility. We have seen that.

But in the end, is it protective and is it administrable? I think it is.

Mr. HARE. How would you respond to Dr. Jeszeck's point that the prevalence and proliferation of consulting work and the complexity of business arrangements among investment advisers, plan consultants, and others have increased the potential of conflict of interest to which workers in D.C. plans are particularly vulnerable?

This concerns me, since the D.C. plans account for the majority of the private-sector retirement plans and participants that we have.

Ms. NUSSDORF. I think that the issue of gearing the disclosure to the level of every one of us, as opposed to a sophisticated money manager, is critical. And so we all focus on what kind of information, what kind of advanced disclosure, what kind of graphic understanding should an investment adviser have to give me for my IRA to make me think, "Whoa, maybe I don't like that advice. Maybe I want to ask some more questions."

That is really the focus. So you have to say to yourself, "Where is the disclosure? Where is the audit? Where is the graphic information that leads a participant to be a little skeptical?" It is good to be a little skeptical.

And the thing that the Department tried to do was to make it plain each time to every participant that, if they wanted independent advice, they could have it. And I think that that is a huge safeguard.

Mr. HARE. Mr. Oringer, I just wanted to take issue—excuse me—with your premise that ERISA has discouraged employers from arranging for financial advisers for their employees or that the rules barring the conflicted advice restricts the range of expert personnel.

As we have seen in this hearing alone today, Mr. Baker left a Fidelity manager for an independent consulting firm for his employees, and GuidedChoice successfully provides independent advice to its clients who have seen really good returns on their investments.

So I believe it is possible to protect investors from conflicts while also ensuring that they receive quality, wide range of advice. I just wonder if you had any thoughts on that.

Mr. ORINGER. Sure. ERISA by no means bars the kind of independent advice that you have just referred to, and that kind of independent advice is terrific.

The fact is, though, that there are a number of employers who are nervous, given ERISA's co-fiduciary liability rules, to retain such a third-party adviser. The fact is, as you go counsel employer to employer, there will be employers who are willing to take that step, but there are just plenty of employers who are not willing to take that step.

And that, I think, is the reason that you see so many participants failing to have this advice. I don't think it is purely a cost issue. I think the fact of the matter is that employers who generally do want to see their participants with this advice just find the legal structure as too risky.

Mr. HARE. Thank you.

Thank you, Mr. Chairman.

Chairman ANDREWS. Thank you, Mr. Hare.

The gentleman from California, Mr. Hunter, is recognized for 5 minutes.

Mr. HUNTER. Thank you, Mr. Chairman.

Thank you, panel.

My first question—is for Mr. Baker. You went out to get that independent advice, right?

Mr. BAKER. Yes.

Mr. HUNTER. Who forced you to do that?

Mr. BAKER. We forced ourselves.

Mr. HUNTER. Nobody made you do it?

Mr. BAKER. No one made us do it. We went to a conference. We understood——

Mr. HUNTER. What made you decide to go do it on your own?

Mr. BAKER. Well, probably like a lot of employers, our investment adviser was appointed. And as a committee, we wanted to go through an RFP process and look for not an investment adviser—that is what I referred to—but a retirement adviser. We wanted to find someone that really knew retirement. So we went out, did an independent search, and selected CapTrust.

Mr. HUNTER. Would you have preferred to have been forced to have that independent adviser in the first place?

Mr. BAKER. We did what was right.

Mr. HUNTER. Which you chose——

Mr. BAKER. Yes, we——

Mr. HUNTER [continuing]. To have happen.

Mr. BAKER. We chose.

Mr. HUNTER. Okay. So no one held you over a barrel and made you choose?

Mr. BAKER. No.

Mr. HUNTER. Okay. Thank you, Mr. Baker.

Mr. Oringer, a question for you. In your testimony and just know, you mentioned ERISA's fiduciary duties are among the strongest that already exist in law. Can you explain what that means to me in layman's terms? And as a practical matter, these fiduciary duties would protect participants in investment advice contexts. Would they do that now?

Mr. ORINGER. Sure. ERISA's fiduciary duties—particularly when it comes to conflicts—the general rules are extremely unforgiving. Notice does not cure an ERISA conflict. Fairness does not cure an ERISA conflict. The self-dealing rules are intransigent in this regard.

And so when you have conduct that you want to permit which does have some conflicts around it, you are going to need an exception or an exemption if you are going to want that conduct to be permissible under the ERISA rules.

So, for example, you may have securities regulation which draws an appropriate balance and is willing to accept certain kinds of conduct with the proper notice and with the proper fairness. But ERISA won't cut that same deal. So if you want to permit that same conduct under ERISA, you have to do something about it.

Now, in terms of helping participants, that is a good structure, because what it does is it sets up a situation where you are not going to permit this admittedly more dangerous conduct unless you go and act to permit it, as you did in the PPA, the Pension Protection Act.

As to the question of whether or not any particular balance is drawn in exactly the right place, you know, we can and, in fact, are debating that. But that is the ERISA structure. It sets up a situation where you can't move with a conflict. And only when Congress or the Department of Labor decides that the conflict is acceptable, do you then have permissible action.

Mr. HUNTER. Thank you, panel.

Mr. Chairman, I yield back the rest of my time.

Chairman ANDREWS. Thank you, Mr. Hunter.

The chair recognizes the gentleman from Connecticut, Mr. Courtney, for 5 minutes.

Mr. COURTNEY. Thank you, Mr. Andrews. And thank you for holding this hearing, which in many respects I think is really focused on the central economic challenge we face as a country, which is creating a system that people actually believe in and have confidence in.

And, Mr. Baker, your testimony describing what your company did and seeing people vote with their feet, in terms of participating in the plan, to me, that sends the most powerful message of the hearing.

And I guess, you know, when we listened to the debating or the contending sort of models that we have before us, which is a plan that provides for a broad range of advice with full disclosure, versus a plan where people have upfront the awareness that it is an independent system, in terms of giving advice, I guess what I would ask you is that—I mean, just sort of through your own experience, with your own workforce, if the choice was given to people, well, you have—you know, we are going to have a different type of plan—system of advice, where, you know, there could be advisers who have some conflict, but will disclose all that information to you, I mean, based on your experience, would people have reacted the same way as opposed to the message that you sent with what you did?

Mr. BAKER. The message I was trying to deliver is that life in a conflicted investment adviser is unacceptable after living life with an independent retirement adviser.

When we look at what drives the committee, when we go out on the floor and we meet people, I look at them as, well, that could be my brother, that could be my father. And are we doing all we can to make sure their retirement-ready?

And so the 401(k) can be a tool. And we have seen—we have only been with our independent retirement adviser for a year, and these statistics are for the past year. And so it is the right thing to do to look at the individuals that you walk with, work with, and you are doing all you can.

And I am telling you that our experience is, under an independent adviser that we chose, I feel a lot better about the employees. And they, obviously, do, too, because they are not leaving, they are not lowering their deferral rates, and the regular education, that is very important to them.

Mr. COURTNEY. Thank you. I mean, I am a relatively new member of Congress. I was an employer a very short time ago and remember the meetings we had on an annual basis on our 401(k) plans. And the staff that would sit down with the advisers, I mean, that is really all they wanted is to have somebody that they were dealing with that they had confidence.

And, frankly, burying them with lots of disclosure data was the last thing that they wanted, because, you know, you are—I mean, you are putting them in almost an impossible position.

And I know—I was watching Ms. Grabot's testimony or reaction, rather, to some of the testimony about, you know, people need the broadest range of advice, I mean, that—in real life, I don't really think that is what a lot of—and maybe you could comment on that.

Ms. GRABOT. Well, I think you have hit on it. I think we have to get to real life. And that is kind of where I live, day in and day out.

First of all, SPDs, they are not read. I know they are under ERISA, but we now have attorneys writing them. Disclosures, I can tell you in our system or even if you sit down with an adviser, you have to say you have read the disclosure. It is like a prospectus.

I guarantee you they do not read it. We spell it out in the interface. And we have pop-up boxes jumping up at them to disclose fees. You can't do it in a regulatory environment, because they are overwhelmed with disclosure. That is the real world. That—it is not about, you know, who is giving the advice and how much disclosure you can put on top of it, because they don't read it, unfortunately.

I do think, though, we do need to discern between the IRAs and the 401(k). With an IRA, as a consumer, I can walk from a particular provider, and it is my individual choice.

With a 401(k) plan, I don't have that choice as a participant. I have to rely on the goodness of my plan's sponsor, which, fortunately, Mr. Baker is a good man, but we don't always have either that goodness or we don't have the sophistication in the plan sponsor community. So they don't understand often times themselves the choices they are making that then impact the participant who cannot walk.

I would also——

Mr. COURTNEY. Really quickly, did the regulations make any distinction between the IRAs and the 401(k) plan?

Ms. GRABOT. Yes, they do, somewhat. In fact, what the DOL did with the computer model to the IRAs I think was excellent work. I mean, they were really trying to discern between the two. And I think it needs to be made clear that they are two different worlds.

Mr. COURTNEY. I interrupted you. I didn't mean to. I don't know if you wanted to a finish a point.

Ms. GRABOT. Well, I think, you know, the last barrier that was discussed a little bit by Mr. Oringer, as far as the employers not being willing to, you know, take on advice as co-fiduciaries, you know, again, in my real-world experience, that has not been the case.

We do have some attorneys—and I tell you, ERISA attorneys never agree on much of anything—so, again, to the real world—so you have the challenge if some ERISA counsel tells you you are going to be a co-fiduciary.

I mean, we are a named fiduciary in our contracts, and we take full and complete liability. And we free that plan sponsor of that pain.

But, you know, in those cases again, that is not the typical situation. The typical challenge is amongst the plan administrators. They don't want independent advice in there, and there is a barrier to the connectivity on the systems. That is the barrier. It is not the barrier of the employers.

Chairman ANDREWS. We thank the gentleman. And we thank the gentlelady for acknowledging responsibility for those pop-up boxes that are so annoying. Is it all of them or just those in the pension——

Ms. GRABOT. You are going to know what you are paying.

Chairman ANDREWS. Okay.

Ms. GRABOT. That is all we care about.

Chairman ANDREWS. Thank you.

The chair recognizes the gentleman from Tennessee, Dr. Roe, for 5 minutes.

Dr. ROE. Thank you, Chairman Andrews.

Thank you all for being here. I am sorry I missed some of your testimony. But I, as Mr. Baker, had the fortune or misfortune of being on our pension committee at our practice. And we grew it from a four-person practice to a 350 employees and 70 providers, so a fairly large group.

And what you all have said is absolutely correct. You do have a—just as the employer, Mr. Baker, I felt a fiduciary responsibility to get the best returns that we could. And we have gone through, as we have gotten larger and larger, we have a pension committee. That pension committee has an independent adviser along with one of the large mutual fund companies, but it is a separate adviser.

And those folks now come in—and before, people—you know, when my nurse would come in and say, "Well, should I invest in this or that?" Whoa. You know, you don't do that.

And, basically, we had the investment adviser team come in with our practice, each individual person, and go over their own retirement, because you are absolutely right. I have had employees with my practice that have been there 30 years, and I want them to be able to retire and have a decent retirement, just like I hope to have a decent retirement.

So I agree with that. One of the things that you can't prevent is, you know, at least Jesse James used a mask and a gun, as opposed to Mr. Madoff who used a pencil to get rid of $65 billion. A crook is still a crook. And I don't know how you are ever going to get rid of that in these systems if someone is dishonest that you are dealing with or just dishonest.

And what you have to do is go on reputation and feedback from other people, just like you select a lot of things.

I guess one of the questions I have for Ms. Nussdorf is—and there is a difference. And you are correct: You can fire your IRA adviser if you are getting lousy returns, whereas in the 401(k) you are sort of stuck with what we as a committee decide to proceed with.

Now, sort of go along with the difference in this, if you would do that for me.

Ms. NUSSDORF. One of the things the Labor Department has done in its regulation is to—let's say the plan sponsor chooses an adviser who has financial affiliations with someone selling a product. Even a participant in that plan has the right to get independent advice. So that participant can say, "Well, my plan sponsor has chosen this institution. I am not comfortable. I want independent advice."

And I think a challenge for all record-keepers and third-party administrators is to do what Ms. Grabot said and somehow get the connectivity for both kinds of advisers on to their systems so participants actually can affect the choice that the Department of Labor has given them.

Dr. ROE. The other thing that I have—and, again, you all may have this—I have never been able to quite figure out what I pay for these services. And I have gone through calculus, and I never have quite figured out, at the end of the year, what we paid. Can that be simplified in any way, where somebody, an old country boy like me can understand it?

Ms. NUSSDORF. Sherrie probably is better than I am at this, but I do think that, at the end of the year, just like your credit card company sends you something that can tell you exactly what you spent and where you spent it, I think that we probably can do a better job at isolating fees and giving them to participants.

The Labor Department is currently working on three different initiatives that would make these fee issues clearer to both plan sponsor and participants. And if they are released sometime soon, I think we will see a real difference in what participants see in terms of fees.

Dr. ROE. Because that is a huge issue, net return—net of fees is a huge issue by what your return actually is.

Ms. NUSSDORF. And it is a big education issue for participants. I am not sure they always see that, and that is something we have to teach.

Dr. ROE. Okay.

Thank you, Mr. Chairman.

Chairman ANDREWS. Thank you very much, Doctor. We appreciate your questions, your participation.

The gentleman from Massachusetts, Mr. Tierney, is recognized for 5 minutes.

Mr. TIERNEY. Thank you, Mr. Chairman.

Let me just ask generally some questions. Certainly, ERISA was done on the premise that there was a need for strict fiduciary standards. Everybody pretty much agree on that?

And are people here trying to tell me that there is no way possible that independent advice is available?

Mr. BULLARD. No, I don't think we—I think independent advice is available. I think——

Mr. TIERNEY. And there are lots of non-conflicted people out there and available to have services on that?

Mr. BULLARD. Well, I would disagree with that. I think as a practical matter, the kind of bundling that Ms. Grabot has been talking about will preclude independent investment advice from being provided by employers. So effectively——

Mr. TIERNEY. If that is done.

Mr. BULLARD. Well, it can be done, but the choice for the participant will be, do I go with the conflicted adviser or do I pay extra for the independent adviser? As a practical matter, independent advisers are not going to be in the game if the class exemption persists.

Mr. TIERNEY. No, I understand that. But I guess my point was that there are independent advisers out there able and willing to perform this service. And I have just—but I don't see any reason at all that justifies deviating from the fiduciary standards that exist in ERISA. And I think we go off that mark at our own peril and our own risk. And I haven't heard anything here that changes my mind on that.

So I will just yield back, Mr. Chairman.

Chairman ANDREWS. Would you yield to me for just a moment, Mr. Tierney?

Mr. TIERNEY. I certainly would yield.

Chairman ANDREWS. I did want to ask Professor Bullard a question, that—I think I read in your testimony that one of the ways that you reconcile this problem that Mr. Tierney's question implies, which is that there are a lot of independent investment advisers out there, but the economics from the point of view of the employer strongly disfavors the independent adviser right now, for reasons that you stated, what was your suggestion as to how we reconcile that conflict in the law?

Mr. BULLARD. Well, there are two ways that you could do it, and they have to deal with the problem Ms. Grabot suggested, which is that one of the benefits of conflicted advice is that it allows for the bundling of services. And there are efficiencies that are realized there. And as Ms. Grabot pointed out, that is the connectivity problem.

What you need to do is have a safe harbor that is contingent on, if—the possibility of conflicted advice being provided, then the employer should have to make sure that there is connectivity for independent advice——

Chairman ANDREWS. So it is your suggestion that we sort of bifurcate this safe harbor, right, and say that, if an employer offers independent investment advice as a fringe benefit, in effect, in his or her plan, that unless the employer is grossly negligent in recommending that person, they are shielded from liability? Is that what you are saying?

Mr. BULLARD. Well, you could. And I think that would deal with the fiduciary issue to the extent you wanted to provide the opportunity for conflicted advice.

But you would not only have to deal with the connectivity—that would have to be required by the employer——

Chairman ANDREWS. So——

Mr. BULLARD [continuing]. But you would also have to have true fee leveling, which means that the real choice being made is, I don't pay more for the independents.

Chairman ANDREWS. So, for example, from Mr. Baker's point of view, his company wouldn't get sued under this safe harbor if the employee just didn't like the advice she was given. As long as Mr. Baker's company exercised due care in choosing the adviser, they would be okay. Is that what you are recommending?

Mr. BULLARD. Absolutely.

Mr. TIERNEY. And I will just reclaim my time then. You know, there is a premium. There is a reason there is a premium on nonconflicted advice, and it may not just be that the employee doesn't like the advice. They may not know that they should dislike the advice. It is conflicted.

You know, and usually that means that nobody is out there waving a flag, saying that there is—"I have an interest in this. I am making a buck, and your costs are going to be higher, and you are going to lose in the long run."

Mr. BULLARD. Yes.

Mr. TIERNEY. And, you know, ERISA was a lot of time and thought and effort—only go back and read the legislative record for ERISA and the reasons for those fiduciary things. And all we are talking about here, it seems to me, is ways for somebody to make a buck or save a buck and put at risk people who should have the anticipation, expectation of being secure and having unconflicted advice.

I yield back.

Chairman ANDREWS. We thank the gentleman for his time, Professor, for your answer, as well.

Mr. Guthrie, do you have questions?

Okay. We are going to go to Mr. Sestak, the gentleman from Pennsylvania, for 5 minutes.

Mr. SESTAK. Thank you.

If I could follow up on that, because that was exactly what—a question I had wanted to ask about what I understand Senator Bingaman had proposed before about a safe harbor in this area.

I have kind of looked at the 401 area, that an employee kind of feels a bit more secure that the employer is looking out for their best interest, and they have selected somebody that is in their best interest. So if—I have liked this last discussion here, and I think it is really one that seriously needs to be pursued.

But let me ask you to take it another step, if you don't mind, ma'am. I have also—so I have kind of looked at trying to somehow say that, boy, that employees, by himself or herself, maybe they get an independent fellow to make sure that the—menu they have got, at least there is this safe harbor and, you know, it kind of attracts that goodness that you have done, Mr. Baker.

But in the IRA area, the individual goes out and selects their plans. Would a possible compromise or something as you are looking at it is that you might have this safe harbor in the 401 area—and I would be interested, Ms. Grabot, what you have to say on this—but in the IRA one, maybe you—because the employee can go out and choose anything they want, even though I think the money initially from the employer has to go to one place, but then they can distribute it where they want, would you then maybe not have the safe harbor in that one? Should we treat that a little differently?

Ms. GRABOT. I mean, I would say, from our perspective, you can treat it differently just because it is an individual—it is just like the—it is more of a retail-type product, whereas in a plan—you are absolutely right—the participant does feel a layer of protection that somebody is looking out for their best interests, which you don't have necessarily in the IRA world.

In the IRA world, each individual is going to go out and shop on their own and do their own personal due diligence. You don't have that opportunity as a participant.

From a practical perspective, even though I can always go get independent advice on my 401(k) plan, I am not going to really know that I even have that opportunity. It might be available to me, but there is no—I mean, I have never seen a plan where they spell out multiple ways of getting advice to a participant.

Mr. SESTAK. Ms. Nussdorf?

Ms. NUSSDORF. Well, in fairness, we haven't seen what the reg can do.

Mr. SESTAK. What? What?

Ms. NUSSDORF. We haven't seen what the reg can do. The regulation has been delayed. Many of us were working on disclosure, trying to make it very participant-friendly, where upfront it would say, "You have the right to have independent advice," and trying to figure out how it would be provided, whether you name the adviser who would be independent.

Mr. SESTAK. But do you think the principle that there might be a different standard would be appropriate, since they are kind of— in one case, you are kind of placed into what your employer chose, but the others you are not?

Ms. NUSSDORF. Well, I do think that the——

Mr. SESTAK. And it is the area that I just can't get my hand on.

Ms. NUSSDORF. I think the standard for IRA, just as Sherrie said, has to be different, because IRA owners don't have anyone except themselves to look to. And I think that they may want to use the regular financial adviser they use for their personal assets on their IRA. I don't think there is anything wrong with it.

Mr. SESTAK. All right.

Ms. NUSSDORF. On the other hand, I do think that, if you really have a system where the employer chooses whoever he thinks is best, but the participant really has accessible and really understands he has accessible an independent adviser, it ought to work. We ought to give it a chance.

Mr. SESTAK. If I could, back on Ms. Grabot. Do you see much of a market out there? I mean, would there be a market—is there a market that—for these independent investment advisers? Some say, "Well, there may not be that many out there." Do you see the growth—I mean, enough out there that we can make a market on this?

Ms. GRABOT. Well, absolutely. I mean, there are some significant changes that have happened in the last just even 5 years. You know, obviously, before the onset of the Internet, it was very expensive to deliver independent advice to participants. It was individual advisers having to sit down with the participant. That is very expensive. Or in your case, Dr. Roe, where they are asking you personally, "What do I do with my money?"

It was very face-to-face-oriented. It is not as if the Internet has solved all the problems. I think the data that you cited where people still want a person is—we still see the same thing.

Mr. SESTAK. So if I could, because I am running out of time, but you see that it would be sufficient, that we could create—if I could——

Ms. GRABOT. Oh, absolutely.

Mr. SESTAK [continuing]. The very last question, Mr. Baker. Have you seen a change in the behavior of how people have done their investments, the equity, you know, fixed income mix change? I mean, you laid out how it had changed—the plan had changed overall. But once you went to this independent investor adviser, did the mix of the plan and their behavior and how they invest also change?

Mr. BAKER. Well, the mix changed. Eighty percent of the plan went from what I call the retail funds that any of us could go buy to an institutional fund.

Mr. SESTAK. Oh, you had said that, I think.

Mr. BAKER. Yes, which was——

Mr. SESTAK. I am sorry. I missed that.

Mr. BAKER [continuing]. Cheaper. The participants saw that.

Mr. SESTAK. I remember now.

Mr. BAKER. And they got to see then the cost of the adviser. To the participants, that is important. Our education explained buying low share cost and the basics of 401(k), but it was a big deal for them for the first time to see what these advisers were costing them. And they can see it on their individual sheets.

And they had to make that choice on value, because we told them, if it is not working, you know, we will change. And we haven't got any protest.

They brought a spirit. We were able to be a lot more open in our 401(k), not only in disclosure of fees, but they saw a more openness in funds. And we were more transparent why we provided these funds.

Mr. SESTAK. Thank you.

Chairman ANDREWS. The gentleman's time is expired. We thank him.

The gentleman from Michigan, Mr. Kildee, is recognized for 5 minutes.

Mr. KILDEE. Thank you, Mr. Chairman.

I came to Congress in 1977. And that was 2 years after this legislation was passed, so I can't take the blame for anything that may have happened here. But Frank Thompson was—we had a task force as part of this Subcommittee. It was a special task force with its own budget. And Frank Thompson used to say that only one person in Washington understood this bill. That was Phyllis.

Chairman ANDREWS. Phyllis Borzi, whose name is always revered around here. She is very welcome in these quarters.

Mr. KILDEE. He had a point there. So I have been here since 1977. I have been on this Subcommittee since that time. We talk about, you know, fiduciary responsibility. And I am asking this question more out of curiosity.

You know, when I—if I go for heart surgery, I don't want to go to a newly minted, you know, general practitioner. And you want competence, too.

You mention that there is an association between inadequate disclosure and lower returns, investment returns. Has there been any study or anything close to a study of some relation between lower investment returns and competence of the person or group that is looking at the strength of the investment?

Mr. JESZECK. Congressman, not—I am unaware of any study that looks explicitly at the level of competence and return.

Mr. KILDEE. I am a Latin teacher, not a lawyer, so I will ask this. I know if you are a lawyer, you take a bar exam. Is there a similar barrier to get into the area of where you take this responsibility on?

In other words, is there any question of competence of those who are trying to protect the investment of those people who have had their money put into that?

Yes?

Ms. NUSSDORF. The Department's regulation requires that in order to provide advice, you not only agree to be a fiduciary and your conduct is governed by either a state insurance commission, the banking regulators, or the Securities and Exchange Commission.

Under the Advisers Act, I believe there are qualifying examinations for advisers.

Mr. KILDEE. Well, the three groups you mentioned—and I am just curious on this—the three groups you mentioned have from time to time not had the best of reputations, right? The SEC recently.

Do you have any——

Mr. BULLARD. The standards—just to give a little more detail—the standards for investment advisers are not under the Advisers Act. Those are imposed by states, but virtually every state has competency standards who are registered individuals who are associated with investment advisers.

Mr. KILDEE. So they would vary from state to state then?

Mr. BULLARD. Generally, states use the same tests, and that is Series 65, which is administered by FINRA, which is the self-regulatory organization for brokers.

Mr. KILDEE. Yet many of these are multi-state companies and multi-state investments. Is there a better way to determine that aside from, you know, being a good fellow, a good person, good young lady, that you are also really competent in this area?

Ms. GRABOT. You know, overall, I think it is extremely challenging. And that, again, delineates the IRA world from the ERISA world. You know, under ERISA, you do have, as a plan sponsor, the responsibility to operate in the best interests of the participants, as well as you have the prudent expert rule.

So when you select a provider of services to the participants, you do have to ensure the competency of the provider that you are selecting. So there is a significant layer of protection there, in that you do have a plan sponsor who has to follow that prudent expert rule.

Outside of the ERISA world, you don't have the same standard. You don't have the same level of standard. But that is not to say that, you know, they are not—there is oversight. There is a registered investment adviser. And they do have, as Mercer was describing, the tests that they have to pass in order to qualify to become an RIA.

But as far as, you know, whether or not fees offset performance, it is the same discussion you have in passive versus active management of mutual funds. It is the same discussion you have, you know, across the board, I think, with competency of financial planners. And there is not, you know, definitive data out there to say one way or the other.

Mr. KILDEE. Well, thank you, Mr. Chairman.

Chairman ANDREWS. Thank you, Mr. Kildee. The gentleman's time is expired.

I did want to mention—implicit in Mr. Kildee's question an issue the president's pension proposals raise about extending automatic enrollment to people without pension coverage, a subject this Subcommittee had a hearing on last year.

We believe it is very important that the protections that the witnesses have talked about today be extended in some form, irrespective of what one calls those accounts, whether they are universal IRAs or employee-directed, that we don't—we want to be sure that this Committee very carefully considers those proposals so that people are afforded all the due protections that have worked so well under ERISA since 1974.

I have several letters, without objection, would like to enter into the record, one October 8th of 2008 from Chairman Miller and myself to the then-Assistant Secretary of the Employee Benefits Security Administration; October 6th of 2008 to the Office of Regulations and Interpretations on this subject from Senators Bingaman, Kennedy and Grassley; and a letter dated March 24, 2009, to Mr. Kline and myself from Fund Democracy, Consumer Federation of America, Consumer Action, National Association of Personal Financial Advisers, the Pension Rights Center, the AFL-CIO, and the National Retiree Legislative Network.

Mr. Guthrie, I would turn to you for any closing remarks that you may have? No?

Well, thank you.

I would like to extend my thanks to you and Mr. Kline and your colleagues on your side of the aisle for your active participation, also to your staff for helping us assemble what I think is a first-rate panel of witnesses. I would like to thank our staff, as well, for your very fine work on this.

I think there is an area of disagreement and hopefully an area of agreement from which we leave today's hearing. The area of disagreement clearly is over the importance and/or desirability of the proposed regulation. Mr. Miller and myself—and I think many others—believe that the record would show the regulation is the wrong way to go.

There are obviously different views on that, and the Committee will take those views into consideration.

Where I hope there is agreement is on the notion that, when you have, you know, $9.2 trillion that you are talking about here, that access to quality investment advice is a consensus priority. I think we are going to disagree over how to provide that, and my own view is that independent investment advice—qualified independent investment advice is the way to go.

But I think there is a shared consensus here. The question is, how best to provide that advice to the broadest range of people so that we can achieve optimal results for people in managing this very, very crucial asset?

I want to thank every single member of the panel for testimony that we will use quite aggressively in the weeks and months ahead. I am certain that any legislation that the full Committee takes up will touch on this area, and we will very much draw upon your comments and your expertise both today and in the future.

The record—as previously ordered, Members will have 14 days to submit additional materials for the hearing record. Any member who wishes to submit follow-up questions in writing to the witnesses should coordinate with the majority staff within 14 days.

Without objection, the hearing is adjourned.

[Whereupon, at 12:10 p.m., the Subcommittee was adjourned.]