S. HRG. 114–665

RESTRICTING ADVICE AND EDUCATION: DOL'S UNWORKABLE INVESTMENT PROPOSAL FOR AMERICAN FAMILIES AND RETIREES

HEARING

BEFORE THE

SUBCOMMITTEE ON EMPLOYMENT AND WORKPLACE SAFETY

OF THE

COMMITTEE ON HEALTH, EDUCATION, LABOR, AND PENSIONS

UNITED STATES SENATE

ONE HUNDRED FOURTEENTH CONGRESS

FIRST SESSION

ON

EXAMINING THE DEPARTMENT OF LABOR'S INVESTMENT PROPOSAL FOR AMERICAN FAMILIES AND RETIREES

JULY 21, 2015

Printed for the use of the Committee on Health, Education, Labor, and Pensions

Available via the World Wide Web: http://www.gpo.gov/fdsys/

U.S. GOVERNMENT PUBLISHING OFFICE

95–692 PDF WASHINGTON : 2017

For sale by the Superintendent of Documents, U.S. Government Publishing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

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C O N T E N T S

STATEMENTS

TUESDAY, JULY 21, 2015

RESTRICTING ADVICE AND EDUCATION: DOL'S UNWORKABLE INVESTMENT PROPOSAL FOR AMERICAN FAMILIES AND RETIREES

TUESDAY, JULY 21, 2015

U.S. SENATE,
SUBCOMMITTEE ON EMPLOYMENT AND WORKPLACE SAFETY,
COMMITTEE ON HEALTH, EDUCATION, LABOR, AND PENSIONS,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:35 p.m., in room SD–430, Dirksen Senate Office Building, Hon. Johnny Isakson, chairman of the subcommittee, presiding.

Present: Senators Isakson, Scott, Cassidy, Roberts, Murray, Casey, Franken, Baldwin, Murphy, Warren, and Whitehouse.

OPENING STATEMENT OF SENATOR ISAKSON

Senator ISAKSON. We welcome all our visitors. We welcome our Secretary of Labor—Secretary Perez, thank you—our other panelists who will testify in a little bit and, certainly, I'm always glad to have Ranking Member Franken here. He keeps me straight all the time. If not straight, at least he keeps me laughing.

Senator FRANKEN. You keep me laughing, too. Is that the proper thing to say?

Senator ISAKSON. That sounds good.

Senator FRANKEN. We're good friends. We are. And you're the cosponsor of my very first bill.

Senator ISAKSON. That's right, which you mentioned on television, which I really appreciate.

Senator FRANKEN. You're very welcome.

Senator ISAKSON. It was the second comment I didn't like very much, but we'll talk about that later.

[Laughter.]

Senator FRANKEN. We're going to not rehash our personal history here.

[Laughter.]

We're going to go right to the hearing, right?

Senator ISAKSON. Only good friends talk like this to each other.

Senator FRANKEN. Yes.

Senator ISAKSON. Let me welcome all of you, and I'll start with an opening statement and then turn it over to Senator Franken for his statement.

A comfortable retirement is part of the American Dream. Unfortunately, the fine print included in hundreds of pages of Department of Labor regulation that seeks to redefine a single word, fiduciary, would deny millions of Americans the chance to plan for one. The new rule would limit access to investment advice for the families who need it most and, in my opinion, is a solution in search of a problem.

By way of example, in terms of that one word being defined by pages of regulation, that's the regulation and the comments by the Department of Labor on the fiduciary rule change, just to give you some idea of how much paperwork it took to explain it.

Senator FRANKEN. Is that like a gift for me?

Senator ISAKSON. I'm going to let you take that home and read it tonight or do whatever else you'd like to do with it.

[Laughter.]

The regulation intentions are commendable to ensure that low- and middle-income families receive the same quality of advice about their investments as wealthy people do. Under the proposal, people who provide investment advice on retirement savings must act in the best interest of the investors or forfeit their fees.

Under the new rule, providers of retirement savings vehicles such as IRAs and 401(k)s must either enter into a contract that says it will act as a fiduciary and benefit only the investor. The problem is that the regulations that govern fiduciary advisors would severely limit products available for retirement accounts and increase fees so much so that low- and moderate-income people would be more low-income, more moderate-income, and less informed.

The rule also requires disclosure of more information than is reasonable or often even at times impossible to provide. Advisors must estimate the cost, level of fees the investor is to pay over multiple years. Because fees often fluctuate, as do rates and return, such estimates are inevitably wrong. For that reason, they are considered misleading and actually banned by the Securities and Exchange Commission.

I might insert here that in my private life, for 33 years, I dealt with Regulation Z in terms of disclosure of real estate and mortgage information. Expressing annual percentage rates and other rates of return at any one point in time can by its very nature be wrong the next day because of changes in markets, and you can penalize people for something that was no fault of their own.

The regulation would also restrict IRA investors to a list of products that the Department of Labor deems appropriate. Why the Labor Department should meddle in investment decisions defies all logic. Yet there is a one-size-fits-all open approach that would prevent investors from diversifying in ways to protect from the downside risk.

The hundreds of investment options that retirement savers now have would be reduced to a mere handful for most Americans. This seems entirely counterintuitive to our public policy goals of increasing retirement plan participation for all citizens of our country.

Worst, because investors must have a contract with their advisors to receive recommendations about what to put in their investment accounts, the millions of existing IRAs and 401(k)s would, in effect, be blocked from getting ongoing advice because those contracts weren't in place when the accounts were created. Millions of people will receive letters from the brokerage firm telling them they will no longer be able to get personalized assistance.

By one estimate, a third of the financial representatives would be forced to leave the business because they couldn't be properly licensed. Having a personal representative matters. According to a 2012 study, three-quarters of non-retired consumers who work with an advisor contribute to a retirement plan or an IRA, while fewer than half of the consumers that don't have advisors save for retirement.

In other words, many working families will not be able to get the advice they need to feel comfortable about the decisions that are made. Studies have shown that losing personal assistance for retirement savings could reduce by as much as 40 percent the amount of savings saved by low- and moderate-income people.

As I told Secretary Perez yesterday on the phone, I am interested in seeing to it that people get quality advice, that those that advise them are responsible and accountable for that advice, and that we do everything we can to improve the access and the amount of savings America's low- and moderate-income families have.

The matter is not the goal. The matter is how you get to the goal and how you define it. In my judgment, that many pages of regulation and that much explanation of a single goal is entirely too much and too restrictive on the access to free advice that these people need to get.

With that said, I'll turn it over to our Ranking Member, Senator Franken from Minnesota.

OPENING STATEMENT 0F SENATOR FRANKEN

Senator FRANKEN. Thank you, Senator Isakson. This is my first hearing as Ranking Member of the Employment and Workplace Safety Subcommittee, and I look forward to working with my friend, Chairman Isakson, and members of the committee on the important role the subcommittee plays with jurisdiction over a variety of employment issues, including workforce education and training, the health and safety of America's workforce, wage and hour laws, and workplace flexibility.

In today's hearing, we are discussing another very important issue, protecting America's workers' retirement savings, and, in particular, a review of the Department of Labor's proposed rule to address conflicts of interest in the retirement advice that Americans receive when managing their retirement nest eggs.

We have read the headlines time and time again that Americans are not saving enough for retirement. I have heard it many times from hardworking Minnesotans about how hard they're working just to keep up and provide for their families, let alone save for retirement.

Saving for retirement is hard, and investing can be intimidating for those without any experience, leaving many to rely on advisors to help guide them through their retirement planning. Most advisors and brokers put the interest of their clients first, and I have heard from a number of them who have sent me letters recently in support of the Department of Labor's proposed rule, including Charlie—I'm going to mispronounce Charlie's name, but it's something like Bolognino. I think it means meat sauce in some language.

[Laughter.]

He is of Side-by-Side Financial Planning in Plymouth, MN. The best meat sauce comes from the western suburbs of Minneapolis.

[Laughter.]

Charles Buck of Buck Financial Advisors in Woodbury, MN, and other Minnesota financial advisors have gotten hold of me in support of this rule. We will also hear from Scott Puritz later today. He is the managing director of Rebalance IRA, and he will be testifying. Mr. Puritz offers his clients asset management and custom investment portfolios for IRAs and offers one-on-one consultation, all while embracing the fiduciary standard, and he charges some of the lowest fees in the industry.

There are also those who charge much higher fees and sometimes even lower returns for retirees. When that happens, it's hard for working Americans who are planning for retirement and they pay the price. These hardworking people shouldn't have to worry about the fact that some advisors don't have their best interest in mind. I think we can all agree to that.

The Department of Labor's proposed Conflict of Interest rule seeks to address this issue. Many groups are supportive of DOL's role, but there are also those that believe the rule will result in unintended consequences. That's what this hearing is about, and that's why it's so important.

This is a process. We will hear from a range of perspectives today to help us understand the benefits and shortcomings of the proposed rule. That's why I was a little taken aback by the title of today's hearing, which is Restricting Advice and Education: DOL's Unworkable Investment Proposal for American Families and Retirees.

If I had been naming it, I could have named it DOL's Fiduciary Proposal: What a Great Rule. I don't think that would have helped much, right? No, of course not.

[Laughter.]

I think the department's intent with the proposed rule is very clear: to help American investors keep more of their hard-earned money for retirement. As the saying goes, "the devil is in the details", and at 400-plus pages, gift wrapped beautifully, there are many details in this rule. I look forward to hearing from Secretary Perez to better understand how this proposed rule will work and from other witnesses on how we can make this rule even better.

Thank you, Mr. Chairman.

Senator ISAKSON. Thank you, Senator Franken.

We'll now turn to Secretary Perez of the Department of Labor. Secretary Perez.

STATEMENT OF HON. THOMAS PEREZ, SECRETARY OF LABOR, WASHINGTON, DC

Secretary PEREZ. Thank you, Mr. Chairman.

Senator ISAKSON. If you could hold your remarks to about 5 minutes, we'd appreciate it.

Secretary PEREZ. I'll do my best.

Senator ISAKSON. Thank you.

Secretary PEREZ. Thank you, Mr. Chairman, Ranking Member Franken, and members of the committee. It's an honor to be here with you.

I want to start by talking about a real person, because behind every regulation or proposed regulation is a real person. Merlin Toffel was a Navy veteran and an electrician. He did everything right. He and his wife, Elaine, raised four kids in suburban Chicago. They built a solid middle class life. They saved their money. They built up an impressive portfolio with Vanguard.

When Merlin was stricken with Alzheimer's and could no longer manage their finances, Elaine made an appointment at the local retail bank. They had used this bank for years. They trusted them. The bank's investment broker told her to liquidate the Vanguard portfolio and sold them a very complex variable annuity to the tune of $650,000. Merlin was something like 75 or 78 years old at the time of the sale of this variable annuity.

Elaine trusted this advice. She thought it was in their best interest. The annual fee on that variable annuity—the annual fee was $26,000, and if the Toffels needed to access the money right away, a 7 percent surrender charge would cost them more than $45,000. In the end, the broker's conflicted advice cost a hardworking family more than $50,000.

This story is tragic but not unique. It's also not illegal, because someone concluded that the advice was suitable. Conservative estimates by the Council of Economic Advisors place the cost of conflicted advice at more than $17 billion annually.

ERISA is over four decades old. In my parents' generation, when you retired, you got a pension, a pin, a party, and that pension was a defined benefit pension. Today, we have an $11 trillion market of defined contributions of 401(k)s and IRAs, $11 trillion.

Times have changed. Consumers now have to make critical decisions about how to invest these funds that they have so hard earned. Three of the most important decisions that people now make are medical, legal, and financial. When you go to a doctor or a lawyer, they have a medical and legal obligation to put your best interest first.

The Labor Department's Conflict of Interest rulemaking is about making sure that the same set of rules—best interest of the consumer—apply to when you are getting help in retirement. Most people assume, actually, that the standard already exists, and that is, indeed, the case for many advisors, like the one my wife and I use, who is a fiduciary, and he does so, and he puts our best interest first. The majority who operate in this space are under no such commitment, although in many cases their marketing actually suggests that they are.

It's important to make one thing clear, and Senator Franken alluded to this. While there are undeniably some bad apples, this is not a case about bad people doing bad things. The majority of folks in this space are trying to do the right thing every day. The nub of the problem is good people who are operating within a structurally flawed system, a market that sees personal financial interests of the advisor and the firm all too frequently misaligned from the best interest of the customer. The result is what we saw happen to the Toffels.

Our goal in this proposed rulemaking is straightforward, to align the best interest of the customer with those of the advisor and the firm. This proposed rule has been the product of a significant amount of outreach to a wide array of stakeholders.

I appreciate the support we've gotten from so many in the industry, people like Brian Moynihan, the CEO of Bank of America, who said, "We believe that doing what is in the best interest for our customers is absolutely the right thing to do." Jack Bogle, the founder of Vanguard, is a very strong supporter of this rule. We'll hear from a witness shortly who plays in this space every day as a fiduciary working with small investors who tells you when you put your customers' interests first, it's great for your customers, and it's great for business, addition.

I also invite you to look at the transcript of a recent hearing we had in the House, because there is a really interesting thing happening right now. The conversation is shifting from whether to have a best interest standard to ensuring that a best interest standard can be effectively implemented. I'm heartened by that shift. We welcome any and all suggestions on how to improve the proposed rule to ensure that it can be effectively implemented.

We've heard and understand concerns that have been raised about issues, such as point of sale disclosure, data retention, and the mechanics of implementing the best interest standard. As long as we don't lose sight of our north star in enforceable, best interest commitment, we are very flexible on the question of how to get this work done. This is about providing guard rails, not straight jackets.

It's important to remember as we go through this rulemaking that a substantial subset of the advisors already operate under a fiduciary model. They serve a wide array of customers, including small businesses, small investors, and they do it well. We know that it can be done, because it is already being done by so many businesses.

A number of folks have raised concerns that the proposed rule will shut out the small saver from investment advice. Entities such as the Consumer Federation of America, entities such as AARP—they take a back seat to no one, and they're concerned about small investors, and they strongly support this rule.

We've consulted with several profitable firms whose business model is all about working with the little guy. There was an investment firm out in Palo Alto called Wealthfront. They cite their success as,

> "living proof that not only is it possible to provide fiduciary service at low cost to small investors nationwide, but the market greatly rewards this effort."

When I talk to firms like this and tell them about the argument on the other side, that our rulemaking will make it impossible to serve the small saver, the most frequent advice I get is "Give them my phone number, give them my email, because you know what, I'll take their business any day of the week." I know that the industry can adapt to serve this $11 trillion market, and I'm confident that we can work with them.

We've reached out, in addition, to small savers, to small businesses who want to ensure that their employees have access to retirement plans so that they can recruit the best and the brightest.

Our proposed rule has a number of safeguards and safety valves so that they can access retirement plan options for their employees.

As Kelly Conklin, a small business owner from New Jersey, told us,

> "I am all for this proposal. I don't have a big firm with our own in-house financial management team that can advise me. I want the financial advisors I work with to be required to represent my interests."

That's precisely what we're trying to do, build a big table, invite everyone up. I believe one of the most important things you can do when you're doing rulemaking is build a big table, listen, and have a healthy dose of humility. That has been our approach: humility, good faith, an open mind, and a keen ear.

We know our destination and enforceable best interest standard. It's in the line of Ronald Reagan—trust but verify. Your marketing material says that you look out for your customers' best interests. This standard is memorializing what is in the marketing materials.

We're open to different routes to getting to that enforceable best interest standard, and we look forward to continuing to hear from as many voices as possible. We've extended the comment period. We're convening 3 days of public hearings next month, and then we'll reopen comment after we publish the transcript of those hearings. We look forward to the engagement.

We have gotten so much good feedback from so many businesses who have come in with a get-to-yes attitude. They have challenges, they have questions, they have concerns, but they have a get-to-yes attitude, because they recognize, like Jack Bogle said, that when you put your customers first, it's great for your customer, and it is, indeed, great for business.

This is about middle class security, and one of the pillars of middle class security is retirement security. I look forward to working with this committee and with all the stakeholders to continue the process of producing a rule that will work for American savers and will work for American business and will work for all stakeholders.

Mr. Chairman, thank you for your time.

[The prepared statement of Secretary Perez follows:]

PREPARED STATEMENT OF THOMAS PEREZ

Thank you for the invitation to appear before the subcommittee to speak about the Department's proposal to protect workers from conflicts of interest in retirement investment advice. As this subcommittee explores the issues facing America's workers, I'm pleased to have the chance to discuss this rulemaking, and hope that we can continue to engage in a productive dialog. We believe that we have proposed a reasonable, middle-ground approach that is responsive to our extensive outreach and feedback. It is grounded in a basic principle—that investment advisers should act in their clients' best interest not their own. The proposal's 90-day comment period closes at the end of today, and will be followed by public hearings that begin August 10th. The comment period will reopen on the day of the hearing and remain open until 14 days after the hearing transcript is published—a process that we anticipate will provide an additional 30 to 45 days of public comment. I want to assure all stakeholders, including Congress, that the Department is appreciative of the comments received to date, which have already begun to sharpen our thinking about potential changes so that the proposal accomplishes its goals in the simplest, most practical way for all concerned.

Retirement security is a fundamental pillar of the middle class. We must ensure that Americans who work hard and save responsibly for retirement are getting a fair share of the returns on those savings. This subcommittee knows too well that there is a retirement crisis in America and that not enough Americans are saving for retirement. I'm deeply concerned that even if you've done the right thing, worked hard, and saved what you could, you could end up in a situation where you do not have what you need for retirement simply because your adviser isn't required to put your interests first. The majority of advisers already does the right thing and serves the interests of clients first, but most Americans do not have room for error and cannot afford to invest in products with unnecessarily high fees or low returns that benefit their advisers but do not meet their own needs.

Throughout my career, I've seen over and over again that making the right financial decisions is critical to a person's life and future, but that far too often, people don't have the information and tools they need to make the best decisions. When I was in State government and at the Justice Department, I saw firsthand how the foreclosure crisis turned the American Dream into a nightmare for millions of families; I saw how it turned thriving communities into decaying neighborhoods.

The crisis was a function of inadequate regulation and irresponsible, sometimes predatory, lending practices. But it was also a stark reminder of how little so many of us understand the biggest financial decisions we make, and how we so often have to rely on what we are told by professionals, and to trust that they're giving us the best information.

The biggest decisions we're faced with fall into one of three categories: medical, legal or financial. Most people know that lawyers and doctors have an obligation to look out for what's best for you. When you go to a doctor, you expect to get advice that's in your best interest. If you have cancer, you don't want your doctor telling you just what's "suitable" for you. You need your doctor to tell you what's *best* for you. When you hire an attorney, that attorney is legally bound to work in your best interest.

And most people assume the same is true for professionals who provide financial advice. You should expect that when you are relying on someone to provide retirement investment advice, they are going to tell you what is best for you, not what earns the most money for them. But in reality, conflicts of interest and hidden fees too often result in bad advice that is not in our best interests.

There are many advisers who work every day to do right by their clients. Some financial advisers commit to serve your best interests. But others operate under no such commitment, and there's nothing stopping them from getting backdoor payments at their client's expense. The corrosive power of fine print and buried fees can eat away like a chronic illness at a person's savings.

An analysis by the Council of Economic Advisers concluded that this kind of conflicted advice leads to losses totaling about $17 billion every year for IRA investors. Losses due to conflicts of interest, on average, reduce returns for affected savers by about 1 percentage point per year. Over 35 years of saving, this could reduce savings by more than a quarter. And in many cases, the affected consumers don't even know it is happening. The lack of rules of the road is confusing, it creates an unlevel playing field, and it hurts working people who just want to be able to save enough to retire comfortably.

When I became Labor Secretary 2 years ago I committed to slowing this rulemaking in order to ensure that we got it right. During that time, my review of the evidence has demonstrated that there is in fact a large problem that needs to be solved. I heard from too many hard working Americans whose golden years became tarnished when the savings they thought would carry them through retirement disappeared into high fees and poor performance. One of the people whose story I learned is named Phil, a retiree from California. In 2002, Phil was offered a buyout from the company where he had worked for 30 years, and he was presented with three choices: he could ignore the offer and keep working; he could take the company's pension and receive a monthly check of $1,500 for life; or he could take a lump sum of $355,000—money he had earned. After talking it over with his wife, he decided to call a financial adviser whom the company had brought in a few years prior to provide some retirement advice to employees.

That adviser came to Phil's house, and sat with them at their kitchen table. She encouraged Phil and his wife to take the lump sum and let her invest it for them. When Phil came to Washington recently to tell lawmakers his story, he said

> "I will admit, being a blue-collar union employee and being watched over, cared for and protected by the company and the union my entire career, I was ignorant when it came to these financial matters I had to deal with, and I needed professional help."

As so many of us do every day, Phil and his wife trusted the adviser to guide them in the right direction.

But she didn't do what was in their best interest. Instead, she put Phil's money in investments that weren't appropriate for him, and she misled him about how much monthly income he could safely withdraw. Today, Phil and his wife have lost nearly all of their savings. They live on a strict budget and shop at thrift stores. They're at risk of losing the home they've lived in for more than 40 years. They won't have anything to leave for their kids or grandkids.

In addition to stories like this, the Department's own economic analysis conservatively estimates that the proposed regulatory package would save investors more than $40 billion over 10 years, even if one focuses on just the one subset of transactions that have been the most studied. The real savings are likely much larger as conflicts and their effects are both pervasive and well-hidden.

Even as I became more convinced of the problem, I knew that we had to act carefully to solve it in a way that protected people like Phil, but that avoided unwarranted disruption to the industry. As I assured this committee when I appeared before you just a couple of months ago, our proposal serves three main principles: (1) it updates our regulation to protect retirement savings in the much-changed retirement landscape; (2) it allows flexibility so the industry can use its knowledge and expertise to find the best way to serve its clients and continue to innovate; and (3) it meaningfully responds to the input we received in the extensive outreach that we have conducted. I would like now to show how I believe our proposed rule honors those three principles.

The existing DOL rule was put in place a generation ago, in 1975, when most of America's workers did not have to worry about making decisions regarding how to invest their retirement savings. But now that the retirement landscape has changed, our rules have to change as well. When the rules were last overhauled almost 40 years ago, Individual Retirement Accounts had just been created and employer-based 401(k)s did not even exist. Today, America's workers have more than $7 trillion invested in IRAs and more than $5 trillion in 401(k)-type plans, which, combined, exceed the value of traditional pension benefits. As more baby boomers retire, more and more of them are moving their retirement savings from employer-sponsored plans into IRAs, making the protection of rollovers and IRAs increasingly important. Congress created and encouraged the growth of this 401(k) and IRA marketplace by giving those savings tax preference—as a result, under ERISA and the tax code, we have an obligation to ensure that those savings are protected.

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

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

Our proposal's second principle is best illustrated by the proposal's carve outs and exemptions, which allow for flexibility and workability. The proposed exemptions from ERISA's prohibited transaction rules would broadly permit firms to continue common fee and compensation practices, as long as they are willing to adhere to basic standards aimed at ensuring that their advice is in the best interest of their customers. Rather than create a highly prescriptive set of transaction-specific exemptions, the Department instead is proposing a set of exemptions that accommodate a wide range of current business practices, while minimizing the harmful impact of conflicts of interest on the quality of advice.

At the heart of the proposal is the best interest contract that would govern the advisory relationship if the adviser is receiving conflict of interest fees or other payments. It is an innovative approach designed to respect existing business models while protecting consumers and leveling the playing field for impartial advisers. This principles-based approach obligates the adviser to honor the interests of the plan participant or IRA owner, while leaving the adviser and employing firm with the flexibility and discretion necessary to determine how best to satisfy these basic standards in light of the unique attributes of their business.

The proposal clearly reflects our third principle—a commitment to being responsive to the substantial input we received from a wide range of stakeholders. My staff and I have met with representatives of all of the major financial industry groups, CEOs of big and small firms in the financial services industry, and representatives of employers who offer retirement plans to their workers. I have also met with consumer groups and civil rights groups who are concerned that their members are the ones who can least afford to see their retirement savings dissipated by conflicts of interest among financial advisers they rely on for investment advice. We have also worked extensively with colleagues throughout the government, including and especially the Securities and Exchange Commission.

I am encouraged by the substantial and growing areas of agreement between the Department and the financial services industry. For example, there is an acknowledgment and acceptance among our stakeholders in the financial services sector that there are significant conflict of interest problems in the marketplace serving retirement investors. There is also a broadening consensus around the core elements of a solution, including: (1) an enforceable best interest standard, (2) a requirement that firms carefully design structures and procedures to mitigate conflicts, (3) adherence to the existing securities laws, (4) more effective disclosures to investors, and (5) the need for concrete steps to address fees and other revenue incentives that may improperly influence investment recommendations.

We heard from numerous stakeholders, in both the industry and advocacy communities, that a principles-based rule would work best in this rapidly evolving marketplace. We responded with the best interest contract exemption—a completely new approach that directly addresses these suggestions.

You can also see our responsiveness not just in what the rule will do, but also in what the proposal won't do:

- We heard that banning commissions would cause excessive disruption in the industry—therefore, like the prior proposal, the new proposal does not ban commissions or many other common payments for advisers.
- We heard that including appraisals or valuations of stock held by employee stock ownership plans in this rule was too complicated and not a good fit—so the rule does not apply there.
- We heard that large plans with sophisticated fiduciaries making investment decisions need greater flexibility in dealing with advisers so we included a carve-out for them, commonly referred to as the seller's exception.
- We heard that it was important to provide retail customers who want to direct their own transactions with the ability to place orders without unnecessary process, so the rule will not apply to brokers who just take direct orders from customers and do not provide advice.
- Finally, we heard about the important role that the financial services industry plays in providing much-needed financial education. Because we value that role, the proposed rule does not limit access to financial education. In fact, it would expressly allow employers, call center employees, and other financial professionals to continue to provide general investment education without becoming fiduciaries, and extends this express allowance, historically applicable only in the 401(k) market, to distributions, rollovers and IRAs as well.

The proposed rule and its accompanying Regulatory Impact Analysis includes numerous requests for comments on particular issues—more than any other rule that we have published while I have been Secretary. I think of these specific requests as an invitation to a very real conversation that I hope will prove to be a productive one. Our track record gives us credibility when I say that we are open to making real changes in the rule to improve it, and that's why we urge our partners in the industry and advocacy community to engage in a good faith dialog during the comment process. For example, we included in the rule some illustrative examples of the kinds of practices and procedures that firms could adopt to meet the requirements of the best interest contract exemption. We hope that comments from stakeholders will address whether these are the right examples or whether there are better ones.

Many of you have raised important questions about how this may affect retirement savers with small balances, something we carefully considered while drafting. I simply don't believe the argument that small savers cannot be served by advice that is in their best interest, especially with the advent of new, technology-based and technology-assisted models. We know that advisers can live up to a best interest standard and still make a living because so much of the industry already does just that. Every day, Americans are served by advisers like the certified financial planner with whom my wife and I work, who has embraced the best interest standard. In fact, the rule will help the best advice win out, because those already selling good products or giving good advice stand to benefit in a world where a client's best interest has to be put first. What I've learned through a robust and exhaustive outreach process is that when you put the interests of your customers first, it's good for your customers and it's good for business. Jack Bogle, the founder of Vanguard, made this concept a cornerstone of his business model, and he and other firms large and small have proven that it can be done to great success.

We have put forth a simple proposition—the client's best interest should come first. So far, we have heard from some who want us to go further and ban all conflicts of interest and end commissions, while others have said that we don't need to act at all. Those comments tell me that we have probably found the right middle ground in providing greater consumer protection in a way that respects the important role played by investment advisers in helping the middle class achieve the American dream of a secure retirement. I am most heartened by the comments that offer suggestions on even better ways to achieve that objective. I hope to continue that conversation here with you.

Thank you again for the invitation to testify.

Senator ISAKSON. Thank you, Secretary Perez. We appreciate your attendance and your service to the country.

If your rule was implemented as it's currently contained in this stack of papers here, what would have happened differently to Merlin Toffel and his wife with the $650,000 they cashed in at Vanguard and bought a variable annuity? What would your rule specifically have done with the $26,000 fee, which was the maintenance fee annually, or the 7 percent early withdrawal fee, or any other thing you might determine was wrong?

Secretary PEREZ. Sure. What would have happened differently is that that person advising them would have had an obligation to look out for their best interest. What happens in a suitability standard——

Senator ISAKSON. Excuse me for interrupting. That's a point I want to get to. I understand who they went to was a bank. Is that correct?

Secretary PEREZ. Yes.

Senator ISAKSON. Would that bank be considered—would a bank be considered to meet the fiduciary standard you require?

Secretary PEREZ. They went to a broker dealer at a bank. A broker dealer has an obligation—had a suitability obligation, which is less—which creates part of the challenges that we have in this situation.

Senator ISAKSON. Continue.

Secretary PEREZ. The broker dealer under the proposed rule would have an obligation to look out for the best interest of the consumer. The challenge that we see and the $17 billion annual cost of conflicted advice is born out of the fact that there are multiple products that can be suitable, and that broker dealer is totally within his or her bounds to then take four or five suitable products and steer the customer to the product that generates more fees for him or her at the expense of the customer. We think that isn't right, and we think it should be changed.

Senator ISAKSON. In your vision, how would they be able to remedy the situation with this broker dealer? What would have been the broker dealer's obligation under the fiduciary rule to the lady and gentleman who bought the variable annuity?

Secretary PEREZ. To put the customer's best interest first.

Senator ISAKSON. How do you do that? I mean, what if he said that was in the best interest of the customer? What penalty is there—what do you do to the broker dealer or the person offering the advice to penalize them for what you consider was bad advice?

Secretary PEREZ. You would file a claim for excessive fees to recover the losses that were incurred as a result of the conflicted advice.

Senator ISAKSON. It basically creates a cause of action for an individual who feels like they've been aggrieved to be remedied. Is that correct?

Secretary PEREZ. Right. The proposed rule has a provision in an individual claim like this that the particular bank could have an arbitration clause so that they could require that if there's any claim that arises out of the service they provide, it would be resolved through arbitration. That's one of the proposals in the rule that's in the——

Senator ISAKSON. The advisor would do that or the individual would call for it?

Secretary PEREZ. No. The institution that is working with this individual could, as part of the agreement working with that individual, be able to include an arbitration clause. In other words, it says that if we have a problem, you can't go and file a claim in State court or Federal court. You have to go through arbitration.

Senator ISAKSON. I understand.

Secretary PEREZ. That's a proposal that is taken from—we spoke to a lot of other agencies that are involved in this issue—SEC and other regulators—and that is basically parallel to the procedures that are used in another sister agency.

Senator ISAKSON. It's a meritorious move. You made the statement—you said the nub of the problem—and I wrote fast, so if I missed it, tell me. You said the nub of the problem is, "good people operating in a flawed system." Would you explain that?

Secretary PEREZ. Sure. There is a misalignment between the incentives that a person giving advice has and the best interest of the consumer. For instance, again, getting back to the Toffels, if you have four or five different products under the current suitability rule that are suitable, and the first product, the variable annuity, generates $26,000 a year in fees, and another product which would have a comparable return has a fraction of those fees, you have a perverse incentive to steer them to the product that generates the most fees.

Again, that's totally permissible, so I'm not casting aspersions on the person that does it. I'm saying that that's not right. We can devise a system—and I underscore what I said in my testimony. There's a substantial number of people, including one of the witnesses who will come up on the next panel, who operate under a fiduciary model already. They've demonstrated that this can be done. This is being done.

Senator ISAKSON. Senator Franken.

Senator FRANKEN. Thank you, Mr. Chairman.

Secretary Perez, I know today is the last day of the official comment period, and next month a public hearing is scheduled followed by a second comment period. I've heard from stakeholders who said they are participating in this process and are thankful that the department has provided opportunities for feedback.

Can you share with us how the department has incorporated this feedback in the rule that we have before us today?

Secretary PEREZ. I can talk about the feedback that we have gotten. We haven't made any decisions yet, Senator, on what to do because the comment period is still open, and so we want to take in all the comments that we get during that comment period.

What I can say to you with confidence is that we've gotten some great advice. Again, there have been a number of people who have come in from industry who have talked about how we agree that there should be a best interest standard. We want a level playing field, as you said from your testimony. We have concerns about things like—there are some data retention obligations, and we think you could do it differently.

There's a best interest contract framework, and we have heard feedback from folks saying that it's clunky, and there's a more streamlined way to do it. We have a point of sale disclosure requirement, and people have said that that is not necessary.

What we've done in every circumstance—when someone says that the best interest contract is clunky, our response is, "Tell us how to do it better. How do we retain that north star of an enforceable best interest contract and do it better?" That's the feedback we're getting and it's been really, really helpful.

Senator FRANKEN. And you've incorporated it?

Secretary PEREZ. We haven't made final decisions yet because we won't put out a final rule until after we've gotten all of the comments. I'm quite confident that if history is a guide, the final rule will be materially different than and better than the proposal, because you've got to be a good listener in this business. We haven't made any decisions, and we continue to keep that open mind.

Senator FRANKEN. And you're open to continued suggested fixes from industry and——

Secretary PEREZ. Absolutely. We're not only open. We have affirmatively reached out for it, because there's a lot of folks who know a lot about this, and we want to get their insights.

Senator FRANKEN. Darlene Miller, who is from Minnesota and is going to be testifying in the next panel, is president of PERMAC Industries in Burnsville, MN, and she'll be talking about being a small business owner. She offers a 401(k) plan on roughly 30 employees.

Darlene is helping her employees prepare for retirement and setting the right example for many other businesses. She has some concerns that the proposed rule will jeopardize her ability to provide this important benefit to her employees going forward.

Can you assure us that you will continue to work with business owners like Darlene to make sure that these rules don't have unintended consequences?

Secretary PEREZ. I welcome the opportunity. I read Ms. Miller's testimony, and she's a very successful business owner, not to mention a Minnesotan. We've spent time with small business owners. Small business owners—what they tell me most frequently is,

> "I'm an expert at making my product, my widget. I have 10 or 15 people. I don't have expertise in 401(k)s. I know I want to offer it, because I want to attract the best and the brightest."

What we have done in this proposal is include a number of carveouts for small businesses so that they can continue to do that. Actually, what we do to help protect people like Ms. Miller is we're changing the status quo, because the status quo right now—and she's had a very good experience with her advisor. Other's haven't.

When you have a bad experience with your advisor, under the status quo, if litigation ensues, the defendant is the business. It's not the advisor, because under the current status quo, the person providing the advice is actually off the hook. I actually think that's kind of perverse, and I think it doesn't help people like Ms. Miller.

I'd love to sit down and explain to her the carve-outs that help her and other small business owners, as well as why the status quo actually presents challenges for small business owners. We look forward to doing that with her and other small business owners.

Senator FRANKEN. I'm running out of time, but let me just end with this. Some have said this proposed rule may limit their ability to market their services and products to their clients or even limit small business employers and employees from access to education and financial advice. How would you briefly respond to that?

Secretary PEREZ. Sure. We've sought to clarify the line between education and advice. Education is critical. The educated consumer is the best customer. What we've done here is clarify that, for instance, if you want advice on how to apportion your portfolio, how much is going to be in index funds, how much is going to be international, et cetera, that's——

Senator FRANKEN. Asset allocation.

Secretary PEREZ [continuing]. Asset allocation. It's totally education. You can run simulations about different asset allocation models, and that is education. Those are the critical nuts and bolts of advice.

What we've told people who have said to us, "We feel the line between education and advice is either blurred or should be drawn differently"—again, our response is, "How would you do it better, and what ideas do you have?" We've heard feedback to that effect.

We attempted to be responsive the first time around, and our proposed rule is quite different from the 2010 rule in the education-advice context. We continue to look forward to hearing more advice.

Senator FRANKEN. Thank you.

Senator ISAKSON. For the benefit of the panelists who are going to testify in the second panel, I'm going to be very strict on the 5-minute rule, and I'd appreciate you holding your answers to a concise answer so we can get everybody's questions in, because we're on a definite hard stop at 4 o'clock, and I don't want to cut our other testimonies short by running out of time.

Secretary PEREZ. OK, Mr. Chairman.

Senator ISAKSON. Senator Scott.

Secretary PEREZ. Good afternoon, sir.

STATEMENT OF SENATOR SCOTT

Senator SCOTT. Thank you, Mr. Chairman.

Good afternoon, Secretary Perez. How are you doing?

Secretary PEREZ. I'm doing well. Good to see you again.

Senator SCOTT. Thank you. You, too. Over the last 80 years or so, the SEC has been the primary regulator of broker dealers and investment advisors. That is why Dodd-Frank charged the SEC with having significant involvement in any effort to revisit the standards of care that apply in retail security transactions.

Nevertheless, your department has now stepped—and I would suggest overstepped—into this area of regulation. Last month at a House hearing, you used the phrase, dramatic and extensive coordination, to describe the relationship between DOL and Chair White on this rulemaking. You referred to pages and pages of documentation about meetings and calls between DOL staff and Chair White's staff.

It's one thing to coordinate, but that verb doesn't tell us the whole story. I realize that you cannot speak for Chair White. She can speak for herself. Based on your private coordination meetings with Chair White and the SEC, is it your impression that there is no daylight between your thinking and their thinking on this issue?

Secretary PEREZ. I can't speak for Chair White on this. What I can certainly say is that the feedback we got not only from Chair White but from the career staff there has been extensive. We've been talking to the House Workforce Committee. We've given them, I think, 800 pages of documents showing the extent of the coordination.

In short, I think the proposed rule is a better proposal as a result of our coordination. I would note that we have some overlap, but we are the agency that Congress has charged with enforcing ERISA for over 40 years.

While we have some overlap, we have distinct jurisdictional responsibilities, and that's why ERISA is in our lane. We've gotten some good feedback from them and have incorporated it, but we continue to have that responsibility.

Senator SCOTT. You're suggesting that because of the amount of coordination that you guys are on the same page, or you can't suggest that you're on the same page at this point?

Secretary PEREZ. Again, what I've heard from Chair White—and she has stated this, I think, a couple of times—is that she thinks that the best interest standard is, in fact, the right standard for the SEC purposes. The definition of best interest that we used in the proposed rule is actually taken from the 2011 SEC report that was prepared in the followup to the Dodd-Frank law, and it was done so because, again, we heard a lot of feedback that we should try to harmonize to the best extent possible the work we're doing between the DOL and the SEC. In fact, the key definition is taken in large measure from that 2011 report.

Senator SCOTT. On the fee structure that you mentioned in the example that you gave on the person who had $600,000 or $700,000 and had an annual—what would be an appropriate fee structure for an investment with a proper risk allocation and asset allocation?

Secretary PEREZ. I wouldn't be able to answer that question because I don't know all the facts about their risk tolerance threshold and what they had told their client. What—pardon me?

Senator SCOTT. Do you have—I'm sorry. Do you have—you said you can't really answer that question. Do you have any idea that what went into the actual fee structure in the product that was sold was just basically a mutual fund, or was it——

Secretary PEREZ. No, it was a variable annuity, a very complex instrument.

Senator SCOTT. Did it have a lifetime income that was factored into the fee structure?

Secretary PEREZ. It did, and it was given to a person who was in his mid- to late-70s and who kept very copious records.

Senator SCOTT. Did it have a life insurance component?

Secretary PEREZ. I don't know whether it had a life insurance. What variable annuities try to do is help guard against the risks and help give you more reward. What I've seen in the outreach we have done is that we've had a number of significant challenges in the variable annuity context, and this family—$50,000 is what they lost.

I believe the son-in-law came and testified because Mr. Toffel passed away a few months ago. There was a hearing in one of the committees here, and it was a sad story, and it was preventable, in my judgment.

Senator SCOTT. Part of the challenge that I have with the fiduciary rule as we know it today is that I do believe that while we have an opportunity today to discuss the success or the failures of a representative, that, in most part, so many Americans will be more dependent on social security and less dependent on their own funds because they'll have fewer advisors in the market for them. My thought is that as we find this fiduciary rule going into force that you'll actually have fewer folks playing at the most important level of access, which is the minimum level of access, somewhere around the $100,000 to $200,000 accounts.

I think you'll have more folks making their own investment decisions, hopefully on the internet, where they can have an advisor there. The fact of the matter is that too often, too many people will be making their own decisions, not based on expertise, not based on background, but based on what they hope is a good decision.

Secretary PEREZ. I would respectfully disagree, sir, and there's a witness on the next panel who is doing a lot of work with small investors.

Senator SCOTT. I'll be happy to continue the discussion.

Senator ISAKSON. Senator Murray.

STATEMENT OF SENATOR MURRAY

Senator MURRAY. Thank you very much, Chairman Isakson and Senator Franken, for holding this really important hearing.

Thank you to the Secretary for coming to testify today, as well as our second panel.

It seems to me that families have a lot to worry about today, and questioning the advice that they get for their retirement account shouldn't have to be one of those things. We should all be concerned that workers are losing money out of their pensions that they were counting on for a secure retirement, and making sure retirement advisors are working in the best interest of their customers is essential for retirees as well as for advisors and brokers.

This best interest standard is what is best for our economy to help ensure more seniors have access to a secure retirement. It is important that we get this rule right, and I hope that all sides are going to participate in this process, submit their comments, and we make sure that the final rule reflects the important feedback that you have heard. I hope that our debate can really center on how to get the final language of this rule right.

I know there's been an enormous amount of work put into this since the original version of 2010, and I've heard some critics say that this new rule is either worse than that or we didn't learn from the 2010 version. I wanted to ask you while you are here if you can walk us through some of the changes you've made since the 2010 proposal to make this one better.

Secretary PEREZ. Sure. One of the critiques we heard was that there wasn't a sufficiently robust economic analysis. There is a much more robust economic analysis. One of the concerns that was echoed was about a provision we had to regulate ESOPs and appraisals, and we heard from a number of people that that should be removed. That has been removed from the proposed rule.

We heard that we need to establish a vehicle to enforce the best interest requirement, and so the best interest contract vehicle is that vehicle. It was not there in the 2010 rule. We made a number of changes in response to feedback that we got from people about where the line between education and advice should be, so that's another example, Senator. There are others, but in the interest of time, I'll cite those four.

Again, what we've said is give us feedback on how this works for you and how we can effectively implement it, and if there are changes that can be made, we're all ears.

Senator MURRAY. Senator Franken asked you about what you were hearing. You cited a number of things, key data enrollment, point of sale discussion, a lot of things. I assume that you are remaining open to making appropriate and necessary adjustments to the rule to ensure that it both works and is workable as you get these comments back.

Secretary PEREZ. Absolutely. Again, we've gotten great feedback from all stakeholders. We've had probably 50 meetings since the proposed rule came out with different industry stakeholders. I've been impressed by the get-to-yes attitude. They understand, as Brian Moynihan and others have said from the industry, that this is the right thing to do. They have questions and concerns about how we do it, and they've given us some great feedback.

Senator MURRAY. I wanted to also just ask—the current rule was established about 40 years ago. How has the retirement market changed, if you could just define that for us, since then, that we should be conscious of?

Secretary PEREZ. Right. In the Ozzie and Harriet world of yesteryear, again, people worked 30 years, usually at the same job, and at the end of it, they had their pin, their pension, their party. It was a defined benefit plan.

Today, you have—the defined benefit world is shrinking. It's 20 percent of the market. You have between defined contributions, between IRAs and 401(k)'s—that's an \$11 trillion market, and you have roughly \$2.8 trillion in the DB market. In a year from now, that disparity will continue to widen.

People have to own—in the modern family universe, they have to own these decisions, and that's why a rule that was established 40 years ago when 401(k) was a rural highway in the Midwest and

IRA was your elderly uncle—today, those are part of our lexicon. That's why today's rule—today's consumer protection framework needs to reflect today's realities.

Senator MURRAY. Thank you, and thank you for all of your hard work on this and for your continuing work to make the rule work at the end of the day. I really do appreciate it.

Mr. Chairman, I will yield back my time. I know you've got a second panel.

Senator ISAKSON. Thank you, Senator Murray.

Senator Baldwin.

Senator BALDWIN. Thank you, Mr. Chairman.

Senator ISAKSON. Senator Cassidy, I was told you weren't ready. Are you ready now?

Senator CASSIDY. No. Go ahead with Senator Baldwin.

Senator ISAKSON. Senator Baldwin.

STATEMENT OF SENATOR BALDWIN

Senator BALDWIN. Thank you, Senator, for yielding. I want to thank the Chairman and Ranking Member both for convening today's discussion.

Secretary, you just outlined some of the significant changes in the retirement marketplace. If you think about the ways in which it's changed since ERISA was passed in 1975, it's quite significant. I worry about what the future looks like for those trying to achieve the American Dream, living in the middle class, worked hard their entire life, but perhaps in the recession lost work, needed to dip into savings, needed to do so for sending their kids to college—all that would have otherwise gone toward retirement, in addition to any pension plan they had, but isn't available anymore.

We know that workers are not saving enough for their retirement. We know, as you've outlined, that there has been a real shift from defined benefit to defined contribution plans. That shift puts more responsibilities on workers' shoulders to manage risks and to manage the decisions, oftentimes without having investment expertise.

You've actually covered a lot of territory that I hope to cover in my questions with you, in particular, about how workers with smaller accounts, those who arguably need the retirement protection the most, will have access to high-quality and affordable advice.

I'm going to move to something a little bit more specific, given some of the proud traditions in my home State of Wisconsin. We actually have a real history of cooperatives and mutual ownership companies, so companies that are owned by——

Secretary PEREZ. Northwest Mutual, for instance.

Senator BALDWIN. For instance.

Secretary PEREZ. I got married 2 miles north of their headquarters.

Senator BALDWIN. I had a very good visit not too long ago. I would say, and I would just—while tooting the horn of my State—say that a lot of those traditions root back to Wisconsin's progressive era, when people like Senator Robert M. La Follette, Sr.—Fighting Bob as he's known in the State—really laid the groundwork for the formation of a number of these companies.

A lot of them have gained incredibly valuable experience that's sort of embedded into the products that they sell. I'd like you to talk about what assurances you can give to these sorts of companies that they will continue to be able to sell their own retirement products as we move forward.

Secretary PEREZ. Sure. Those are sometimes referred to as proprietary products, and the rule is the same. Whether you're Northwest Mutual, which has a long and distinguished history—and, again, I got married like a mile and a half north of their world headquarters in Milwaukee. The rule is, again, putting your customer's best interest first.

Part of that is making sure you have policies and procedures in place to oversee your sales force. That's true whether it's Northwest Mutual. That's true whether it's the ABC Bank. A big part of what the best interest standard means is that you have those internal policies.

For instance, you're insuring—in the case of like a Northwest Mutual that might want to sell a proprietary product, one thing I would suggest that might be a good idea to ask is that it ought to be a product that a reasonable independent person would recommend to the customer. One thing we've seen—and I'm not saying we've seen it at Northwest Mutual—but one thing we've seen in the course of our outreach is that sometimes sale incentives become perverse. If you sell X number of one product, you get a trip to Hawaii. Or I've even heard about the trip to the Masters.

When that person walks in to give me advice, I don't want them looking at me, thinking, "You're the only thing between me and Hawaii with my family." That is when you have a misalignment of incentives, and that's what we're trying to address by making sure that we have the best interest standard in place.

What the best interest standard does not mean is that you have to sell someone the lowest fee product, because I don't buy a Ugo because it's a crappy car, even though it's the lowest cost. That's why it's no longer on the market, I believe.

The point is it's not about the lowest cost. It's all about—the north star is the best interest of the customer. I think places like Northwest Mutual or the ABC Bank or the broker dealer or the person who's working with the small business owner, like Ms. Miller—the north star is the same for all of them.

Senator ISAKSON. Senator Warren.

STATEMENT OF SENATOR WARREN

Senator WARREN. Thank you, Mr. Chairman. It is hard, really hard, to save for retirement, and the stats bear this out. Almost one-third of Americans on the edge of retirement have zero savings, and another third have less than a year's worth of income put away. That's why it is doubly important that every dollar that someone puts away for retirement is protected.

Many Americans rely on investment advisors for guidance on how to save for retirement. Most of those advisors have their savers' best interest at heart. Not all advisors put their customers' interest first, and that's created a hole that's draining $17 billion a year in retirement savings, money that's going into some investment advisor's pocket instead of into the pockets of the people who are trying to save for retirement.

Thankfully, that hole may soon be plugged with the new rules that would require brokers and advisors to put their customers' interests first. I have just two quick questions about this, Secretary Perez.

As I understand it, several studies, in many of them, most Americans don't even realize that their investment advisors, their retirement advisors, aren't actually required to put the clients' interests first. They think that if they go to someone who advises them that their interests will be first.

Can you explain just very briefly why it is legal today for advisors to steer clients into products that line the advisors' pockets while draining away the clients' savings?

Secretary PEREZ. We have folks who are operating under the fiduciary model, like my—we go to a certified financial planner. That person is required to put our interests first.

A very quick example: the first thing he said to me was, "Keep your thrift savings plan, your Federal stuff from your Federal employment—keep it in the thrift savings plan. I can't do any better." That's an example of putting our interests first.

Senator WARREN. Even if he won't make any money from that advice.

Secretary PEREZ. He didn't make a dime off of that. I've referred a number of clients to him because he looks out for me.

Senator WARREN. There you go.

Secretary PEREZ. That's why it's good for business. The person who is under a suitability standard—again, there are a number of products——

Senator WARREN. Let me stop you right there. I get the suitability standard. What I don't get is why—how did it turn out to be legal? What went wrong? Why is that legal, Mr. Secretary?

Secretary PEREZ. It shouldn't be, and that's why we're trying to change it, because I think the suitability standard is facilitating this misalignment——

Senator WARREN. When was the last time we updated these laws?

Secretary PEREZ. We haven't updated our laws in earnest in 40 years.

Senator WARREN. We've got a problem with outdated laws, loopholes in the laws, and that's how we end up with these two different standards.

Secretary PEREZ. Right. Again, we didn't think about IRAs and 401(k)s back in 1975. We were in the defined benefit world. This stuff just didn't matter because people had a guaranteed pension.

Senator WARREN. All right. You've proposed some commonsense rules to try to close these loopholes, to try to update the laws, just to make sure that all advisors are putting the customers' interests first. Lobbyists for some of the biggest financial companies and some investment advisors are fighting this proposal tooth and nail.

Help me out here, Mr. Secretary. What is it they're so worried about?

Secretary PEREZ. I'll let them speak for themselves. I can tell you—I guess I'll say two points. No. 1, I have been heartened by the remarkably constructive conversations I've had with so many industry stakeholders. As I said in my testimony, there has been an undeniable shift toward a recognition of the need for the best interest standard.

Then there have been folks who have been out there since the outset—Merrill Lynch and B of A—and then there are others who are coming to us absolutely wanting to get to yes. Those who are perhaps in a different place—they tell me that they would like to think that they put their clients' best interests first now. My response to that is, "There's good news, then, for you. This will be easy to comply with if you are, in fact, putting your customers' best interests first."

I think it is something that can be done. I hear from so many folks who are playing in this space day in and day out. We need a level playing field, because people go to their advisor—and, actually, there are some advisors that are dual hatted, depending on what part of the transaction it is. Sometimes they're a fiduciary, sometimes they're not. It's already confusing to begin with. That's stunningly confusing, and we need one standard, and it ought to be the best interest standard.

Senator WARREN. I love the one standard. I love the best interest test. I assume there are a lot of people, though, who are making a lot of money. That $17 billion is going somewhere. It's not staying with the retirees.

I've got to say this one seems like a no-brainer to me. Hardworking Americans who manage to pull together some money for their retirement should be able to trust that their retirement advisors are looking out for them. Besides that, the thousands of honest, hardworking advisors and brokers around this country who already put their clients first every day shouldn't have to compete against those unethical advisors who don't.

I understand why we're in this fight. I understand there are people who are making money from keeping the game rigged. We don't work for them. It's time to level the playing field.

Thank you, Mr. Secretary.

Thank you, Mr. Chairman.

Senator ISAKSON. In the interest of the four panelists who will testify afterwards, I want to introduce Senator Casey, who will be brief within his 5 minutes, and we'll go straight to the second panel, and I think we'll have enough time to hear from everybody.

Senator Cassidy.

Secretary PEREZ. Good afternoon, sir.

Senator CASSIDY. Hey, Secretary Perez.

Secretary PEREZ. It's good to see you again.

STATEMENT OF SENATOR CASSIDY

Senator CASSIDY. Good to see you. I don't pretend to understand this as you do. Let me just kind of channel that which people have asked of me and then ask you to comment upon it.

A fellow came and said,

> "Listen. I have a client. He's pretty well off. I go into his office, help him with his financial planning, and he says, 'Do you

mind just speaking to my employees and give them general advice about how to handle their money?' "

And he goes,

> "I do it as a favor to my client, but I think under this rule I'd have to have each of those employees sign a contract before I'd be able to give them the advice I'm giving them."

Is that true or not? I don't know. I'm asking.

Secretary PEREZ. I don't think that's true for the following reason. If you're sitting there telling workers,

> "Here's what you need to think about, workers, to have a healthy retirement. What's your risk-tolerance threshold? If you're married, what's your wife's or husband's risk tolerance"——

Senator CASSIDY. I think you may have gotten to the nubbin of where I was. You don't think so, or you know not?

Secretary PEREZ. You need to give me more facts, Senator, and then——

Senator CASSIDY. I'm saying this not to be pedantic, but just because if he—unless he has clarity from DOL, he won't have clarity in terms of how he conducts himself. Would he say,

> "OK. I want you to sit here, and I'm going to say this is what you should do with your money. If you're younger, put it in this. If you're older, put it in that. First you've got to figure out your risk tolerance, et cetera. Thank you. Good to see you. I hope you're all well."

That's sort of general advice. Would that be something that they would need to sign a contract for?

Secretary PEREZ. General advice that is not "Go pick this product or that product," but "Go into mutual funds, go into index funds, go into something like that"—that is advice in the area of education or asset allocation. That wouldn't cross the line of education.

Senator CASSIDY. Sounds great. I am told that the United Kingdom put in laws similar to this in 2013 and that banks stopped offering investment advice to customers with less than $80,000 in assets. It may be that the answer to Senator Warren's question is that this model works for those lower and moderate-income people, or at least those with moderate assets.

Just comment on that again. I don't know whether it's true or not. Just your thoughts on that.

Secretary PEREZ. It's not true, and let me give you the facts. After the United Kingdom put in place their regulation—and, by the way, their regulation bans commissions. We don't ban commissions. Their advisors dropped 310,000 clients, and 820,000 new clients came into the market. There was a net delta increase after the regulation of over half a million. Investors with low balance accounts continued to be served, because you were concerned about that.

Here's the most interesting data point about the United Kingdom—I traveled there personally to meet with them, because I heard that feedback a lot. The most interesting point about what happened in the United Kingdom, Senator, is that more and more people are now getting in lower cost funds, because the problem with our system in the United States is it incentivizes complexity when simplicity is all too frequently what is called for. It incentivizes complexity because complexity generates more fees, just like the variable annuity I described.

The U.K. experience—I welcome further inquiry into it, because there's been a fair amount of incorrect information surrounding it.

Senator CASSIDY. OK. The last thing, just to say, the DOL is estimating that the cost of the rule be between $2.4 billion and $5.7 billion over the next 10 years, and yet I'm given a study by Deloitte which suggests that over 10 years, it could exceed $15 billion. Any thoughts on that discrepancy?

Secretary PEREZ. I think our cost-benefit analysis is quite strong. We estimate the benefit over the next 10 years to be $40 billion. In an $11 trillion market, the cost of conflicted advice—when you have a $50,000 loss for the Toffels, in an $11 trillion market, it adds up fast. These are folks who can ill-afford to lose this.

The benefit I'm hearing from employers, like one of our next panelists, has been that market forces are working to the advantage of small investors. I hope you'll talk to some of these folks who are already fiduciary, Senator, and doing great work.

Senator CASSIDY. I yield back. Thank you.

Senator ISAKSON. One of our members is grossly late, but he's my dear friend. His staff has been doing a good job of convincing me he only has 2 minutes worth of questions. Is that true?

Senator WHITEHOUSE. I am fully convinced, Chairman.

Senator ISAKSON. We have four other people to testify before the 4 o'clock vote, so I'm going to recognize Sheldon Whitehouse, who will be brief.

STATEMENT OF SENATOR WHITEHOUSE

Senator WHITEHOUSE. Very well.

Mr. Secretary, you can answer briefly, too. I have heard from companies who are major providers of services to investors who are totally on board with the notion that they should have the responsibility of meeting the fiduciary standard but are concerned that around the edges, things like the way in which they communicate with vast numbers of customers might be affected by this probably in ways that none of us would intend.

I just want to make sure that you will be attentive to trying to make sure that there's not too much regulatory sprawl into areas outside of what we all expect, which is to keep them putting the interest of the client first.

Secretary PEREZ. Absolutely. We had that conversation earlier, and we certainly had a number of very constructive meetings with firms who have addressed concerns, I think, similar to that, and it certainly wasn't our intent. Again, our question that we always ask is,

> "Show us in the proposal where you think that concern arises, and then give us some potential solutions for that so that we can contemplate how to make sure that we're getting to the right place."

Senator WHITEHOUSE. Very good. Thank you very much.

I'm well within my 2 minutes, Mr. Chairman.

Senator ISAKSON. Let the record reflect that Sheldon Whitehouse was brief.

[Laughter.]

Senator WHITEHOUSE. You don't have to make it sound like that's a novelty.

Senator ISAKSON. It was refreshing.

Secretary PEREZ. Mr. Chairman, thank you for your courtesy, as always. It's always a pleasure to be with you.

Senator ISAKSON. Thank you.

Will our second panel please come forward?

In the interest of time, I'll begin the introductions of our panelists so we can get straight to their testimony. First, Peter Schneider, who is the president of Primerica, which I'm proud to say is a Georgia-based company that I have visited before.

Thank you for being here today, Peter.

They are a leader in financial services, providing services to the middle-income marketplace, offering retirement savings options and insurance to millions of Americans. Mr. Schneider became President and served before that as executive vice president for Primerica.

We welcome you here today.

We also have Scott Puritz. Is that correct? Scott is the managing director of Rebalance IRA in Bethesda, MD. He is a retirement expert, having been referenced previously by the *New York Times*, Forbes, and CBS. He is a graduate of Tufts Institute with a master's degree from Harvard University.

Welcome and thank you for being here.

At this time, I'd like to turn to Ranking Member Franken to introduce Ms. Miller, followed by Senator Roberts from Kansas to introduce Mr. Litan.

Senator FRANKEN. Thank you, Mr. Chairman. It's my pleasure to introduce Darlene Miller, who is joining us today from my home State. Ms. Miller is the president and CEO of PERMAC Industries in Burnsville, MN, a manufacturing company that provides precision small part machines to other industries.

PERMAC was named the U.S. Chamber's Small Business of the Year in 2008, and in 2010, Ms. Miller herself was named by the Burnsville Chamber of Commerce as the Businessperson of the Year. I've had the good fortune of meeting Ms. Miller in 2012 when we toured Burnsville Senior High School together to discuss the importance of STEM education. We have also discussed my Community College to Career Fund Act, which would create public-private partnerships to address the skills gap in manufacturing.

Ms. Miller, thank you for being with us today to discuss how you can best meet the needs of your employees.

Thank you, Mr. Chairman.

Senator ISAKSON. Thank you.

Senator Roberts.

STATEMENT OF SENATOR ROBERTS

Senator ROBERTS. Thank you, Mr. Chairman. It is my privilege to introduce Bob Litan, an impressive economist, attorney, and native Kansan. Growing up in Wichita, Bob has become a notable figure in the economics community. He brings a balanced perspective on this issue, and he has been an executive in private, public, and government sectors.

His list of accomplishments, employments, and memberships on advisory boards reads more like a collection of several highly accomplished people rather than one man. He is a current nonresident senior fellow at the Brookings Institution, of counsel to a law firm based in St. Louis and Chicago, and is chief economic advisor at Patent Properties.

I thank you for taking the time to come before this committee today to provide a viewpoint that, unfortunately, seems to be lost, if not solely ignored in this conversation. We look forward to hearing your testimony. We hope that you can offer us some solutions on how we can maintain access for middle- and lower-income families and businesses in regards to financial guidance and retirement planning.

Thank you, sir.

Senator ISAKSON. I hope all the panelists will try and limit their testimony to 5 minutes, and after that eloquent introduction, Mr. Litan, I think you should be first.

STATEMENT OF ROBERT LITAN, ECONOMIST AND ATTORNEY, WICHITA, KS

Dr. LITAN. Thank you very much, Mr. Chairman.

Thank you also, Senator Roberts, for that very kind introduction.

Senator ISAKSON. Turn your mike on, the little switch there.

Dr. LITAN. I'm thanking everybody again for their kind introductions and so forth, OK?

Senator Roberts, I don't want you to choke on these words, but I'm a lifelong Democrat and a former Clinton administration official, but very proud to be from Kansas.

Senator ROBERTS. That doesn't bother me one damn bit.

Dr. LITAN. OK.

[Laughter.]

I say that because I come from a background where I was in an administration where we cared deeply about the kind of goals that the department is pursuing in this proposal. I want to respectfully disagree with the way the proposal has been outlined, and I'm going to make three quick points.

No. 1, the correctly estimated benefits of Labor's proposed rule do not outweigh the cost. This is because Labor gives absolutely no credit or assigns no value to human investment advice, namely, encouraging clients to avoid trying to time the market, one of the worst decisions a long-term investor can make, and also helping clients re-balance their portfolios over time.

When these factors are taken into account, my colleague, Dr. Hal Singer of the Progressive Policy Institute, and I come to the conclusion that rather than generating $4 billion in annual benefits for investors, it would produce net harm of roughly $1 billion to $3 billion annually, depending on how many brokers are induced by the proposal to no longer serve the IRA mutual fund market.

In fact, during a future market downturn, Dr. Singer and I estimate—and we actually show this in our comments that we submitted to DOL yesterday—that by causing many current accounts to be uneconomic to serve, the rule could cost investors as much as $80 billion, double the 10-year benefit estimate claimed by DOL.

I should also mention this connection, that the $17 billion number that's been thrown about by the CEA estimate, in our opinion, is flawed. It's based on a flawed reading of the academic studies, and we show this in our report. In fact, not even Labor counts on the $17 billion. They only use a $4 billion figure, and even that figure, we point out, is incorrect. All right. That's just important to keep in mind.

A word about robo-advice, because I know it's coming up. With all due respect to robo-advice, which I think is an important addition to the market, I think we have to be careful about drawing too much of a conclusion from online or text messaging.

While robo-advisors can certainly help savers identify asset allocations and products to consider, an email or a text message during a market rout is not an adequate substitute for a human being on the other end of a telephone reminding investors of the clear evidence that it pays to stay put if you're a long-term investor, which, by definition, retirement savers are.

No. 2, my second point. If you lose your broker, the only other source of human advice you're likely to go to is somebody who is providing advice on the basis of a wrap fee, which is a percentage of your account. We show in our report that for investors to choose that option, they'll end up paying more than they do under the current regime. This is for small investors.

By the way, I want to underscore something about small investors. Secretary Perez started his testimony by talking about a $650,000 account. That is not a small saver account. There are millions of people here—and I think Senator Warren pointed this out. There are tons of people that have account balances of $10,000 or $20,000. That's all they've got. For those people, brokerage is a less expensive form of human advice than a wrap fee. That is just a fundamental fact.

Third, my last point. The notion that all retirement investment advisors should be held to a best interest of client standard is not controversial. Let's just stipulate that as far as I'm concerned. Let's don't argue about that. It's the way we enforce it. Should we enforce it by potential class action litigation or by a body that we already have established to oversee the brokerage industry, which is FINRA?

In fact, my bottom line suggestion, just to cut to the chase for DOL, is that what they ought to do is go back to the drawing board and go to FINRA—and FINRA, by the way, has offered comments just recently, saying the rule is unworkable and that, in fact, a lot of brokers are going to leave the market, the same conclusion that Hal and I reached.

What Labor ought to do is go back to FINRA and say, "Let's work together and figure out a way to actually administer a best interest rule that you, FINRA, could enforce." By the way, if the problem is insufficient disclosure about whose getting paid and how they're getting paid, there's a simple solution to that: better disclosure, simple disclosure. Just put a great big bold warning on the front of the document that says whose getting paid and how much.

The only basis—and then I'll conclude, Mr. Chairman. The only basis for rejecting that idea, better disclosure, was one study that the Department of Labor cited that's based on experimental evidence, not real-world market evidence. I'm telling you if I were in the government, and I proposed to my superior or secretary or whoever it is that we ought to completely up-end an entire industry on the basis of one study on experimental evidence, I probably would have been told to go back to my office and find another job.

There's absolutely no basis, in my opinion, for at least, at a minimum, not trying better disclosure before we go ahead with this massive undertaking. I think that concludes my testimony.

Thank you very much.

[The prepared statement of Dr. Litan follows:]

PREPARED STATEMENT OF ROBERT LITAN[1]

Mr. Chairman and members of the committee, thank you for inviting me to testify today about the Department of Labor's proposed new rules governing retirement savings investment advice.

My testimony is based on a study of the proposal with Hal Singer, a Principal at Economists, Inc, and a Senior Fellow at the Progressive Policy Institute.[2]

We reach two central conclusions in our report:

- First, contrary to what the Labor Department claims, the benefits of the rule do not outweigh its costs. In fact, during a future market downturn, we estimate the rule could cost investors as much as $80 billion. In part, this is because the benefits are overstated, based on a misreading of the academic research the Department cites. Even more important, the Department did not take proper account of the benefits to investors of brokers and advisers paid on a commission basis, and how investors would either lose those benefits or end up paying more for investment advice than they do now.
- Second, the notion that all retirement investment advisers should be held to a best interest of client standard is not controversial. It's the way the Department proposes to implement it, which because of its costs and risks, will lead to many clients going without an adviser, or if they are able to retain one, only at substantially higher costs, as I outline below. Meanwhile, the Department failed to adopt a simple straightforward fix to the problems of insufficient disclosure on which the proposal is based—namely, simpler and better disclosure. The one study it cites for not taking this obvious step is theoretical and has no empirical grounding in the real world of investing.

To understand how we come to these conclusions, it is important to understand the essence of what the Department is proposing, as well as the February 2015 study of retirement advice by the Council of Economic Advisors which has been widely cited by supporters of DOL's proposal.[3]

Both Labor and CEA believe that the way that many individual brokers and advisers serving those with modest retirement portfolios—or small savers—are compensated generates "conflicted advice," which can only be eliminated if commissions were prohibited. DOL's regulatory analysis claims that a 10-year phaseout of brokerage commissions on mutual funds IRAs would enable investors to earn about $4 billion more annually from their investments.

Before I critique these claims, let's begin with a fundamental fact. It costs money to serve any client seeking retirement investment advice, and the mutual fund IRA market to which the Department devotes most of its attention has developed two basic ways those costs, plus some profit, are recovered:

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[1] This testimony draws on a recent report, supported by the Capital Group, I have co-authored with Hal Singer: "Good Intentions Gone Wrong: The Yet-To-Be Recognized Costs of the Department of Labor's Fiduciary Rule." The views expressed here are my own and do necessarily represent those of the Brookings Institution or the Capital Group, their officers, directors, trustees, or employees.

[2] The study was supported by the Capital Group, one of the largest mutual fund asset managers in the United States. Dr. Singer and I are solely responsible for the analysis and conclusions in the study.

[3] CEA, *The Effects of Conflicted Investment Advice on Retirement Savings*, (Feb. 2015), *available at www.whitehouse.gov/sites/default/files/docs/cea_coi_report_final.pdf*.

(1) through an up-front sales charge which the Department notes has been falling over time, but is now a bit less than 2 percent of the amount invested, coupled with a low annual "12b–1" charge, typically ¼ percent of the total invested; or

(2) a higher annual "wrap fee", which typically is 1 percent or more of the assets invested.

As it is now, many small savers pay brokers and advisers on a commission basis (method 1), while those with larger portfolios often pay a wrap fee, assuming they want any investment advice at all.

If the DOL ends up effectively banning method (1), brokers and advisers have two choices: they can quit serving small savers or they can tell them: "we will continue to serve you, but only with a wrap fee." Those brokers who choose and small savers who accept the second option will end up paying more in the medium to long run than they do now for investment advice. This should be obvious since even a 1 percent annual fee on all amounts invested after 3 years (3 percent) will exceed the average up-front brokers' sales charge plus 2 years of the annual ¼ percent 12b–1 fee (2.75 percent).[4]

Small investors who lose their broker because of the rule—perhaps 7 million or more—also will lose.[5] This is because advisers now provide two very important kinds of advice to investors which also are not factored into DOL's analysis: encouraging clients to avoid trying to "time the market," one of the worst decisions a long-term investor can make, and also helping clients re-balance their portfolios over time.

There is a belief in some quarters that "robo-advice" delivered online can replace human advice from brokers and advisers who find it uneconomic to serve the small saver segment of the market if DOL's rule goes forward. While robo-advisors can help savers identify asset allocations and products to consider, it's a dangerous fallacy to believe that an email or text message during a market rout is an adequate substitute for a human being on the other end of a telephone. As famed Princeton professor Burton Malkiel has written: "We know that investors generally move money to and out of the stock market at exactly the wrong times."[6]

More investors, especially small savers, are likely to make that mistake if they no longer have a human broker to serve them when they are most needed, which is a likely outcome if the DOL is implemented. In our study, we estimate that the cost of depriving clients of human advice during a future market correction—just one of the many costs not considered by DOL—could be as much as $80 billion, or twice the benefits the administration claims for the rule over the entire next decade. Put differently, if investors holding only $1 in $7 invested in mutual fund IRA accounts now are persuaded by their brokers or advisors to hold on through the next major stock market correction and rebound, the gains from doing so would totally offset the 10-year benefits DOL claims for its rule.

As if all this weren't enough, we show in our study that DOL actually overstates the benefits of its rule, and CEA likewise overstates the costs of conflicted advice, by selectively and inappropriately drawing from the academic literature. In addition, we show the weaknesses in DOL's studies purporting to rebut our study's analyses that brokers help clients avoid market timing or help them re-balance their portfolios.

The bottom line from a careful analysis of DOL's proposal is that rather than generating benefits for investors, it would produce net *harm* of $1–$3 billion annually, depending on how many brokers are induced by the proposed rule to no longer serve the IRA mutual fund market. These dollar cost estimates are conservative.

Fortunately, there is an easy and obvious way to avoid this adverse outcome. If the problem is insufficient disclosures of how brokers are paid, then why not require better, simpler disclosure? Our report gives a one sentence example, and also points to one chart that the Department itself proposes as an Appendix to its proposed BIC exemption as a possible solution.

The Department's only basis for rejecting this idea is one academic paper reporting results from a lab experiment—not from the real investing world—in which

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[4] In our report, we refer to an estimate by Oliver Wyman that an investor's costs associated with a forced transition to the wrap-fee model would increase by approximately 75 to 195 percent, depending on the size of the investor's assets.

[5] The Department's Regulatory Analysis breezily dismisses this estimate by claiming that brokers still can receive commissions under an exemption, presumably the new Best Investment Contract Exemption (BICE). But we show in our study, the BICE has numerous restrictions that make it unattractive, and thus not likely to be taken up by many, if not most, brokerage and advisory firms.

[6] Burton G. Malkiel, *Janet Yellen Is No Stock Market Sage*, WALL STREET JOURNAL, June 2, 2015, at A13 (emphasis added), *available at http://www.wsj.com/articles/janet-yellen-is-no-stock-market-sage-1433199503*.

more disclosure didn't work well. But these very same authors elsewhere endorse disclosure as an appropriate remedy for information failure under certain conditions, which Hal and I note in our report are present in the investment advice market.

Even if the study the Department cites were based on real world empirical data—which it is not—using a single study is an extremely thin reed on which to adopt a rule that would fundamentally change the internal compensation systems of many, if not most, brokerage and advisory firms, while imposing massive new paperwork and contracting requirements for millions of clients, all under an impractical 8-month deadline. On top of this, do policymakers in a presidential election year want to face potentially millions of small savers when they receive notices they are being dropped by their longtime advisors or forced to pay much more via fee-based accounts in order to keep them?

Doesn't it make far more sense at least to *try* better disclosure before risking any of this? I trust the question answers itself.

Thank you.

Senator ISAKSON. Thank you.

Mr. Schneider.

STATEMENT OF PETER SCHNEIDER, PRESIDENT, PRIMERICA INC., DULUTH, GA

Mr. SCHNEIDER. Mr. Chairman, Ranking Member Franken, and members of the subcommittee, I appreciate being here today. The Department of Labor's proposed rule is of enormous consequence to the middle-income families we serve every day and in each of your States. Please allow me to tell you a little bit about Primerica, and I like talking about it.

We were founded almost 40 years ago on a central mission, that middle-income families require someone to help them to focus on their financial needs. That was true then and it's just as true today, and we feel like at Primerica we've made some headway.

We insure 4 million lives with our term life insurance. This year, we will pay $1.2 billion in death benefits to families. Those checks, which we deliver every day—and will deliver multiple checks today—keep a personal tragedy from becoming a financial one.

We've helped our clients save almost $50 billion in our investment accounts. Most of our accounts are very small by industry standards, but they're hugely important to the families who opened them.

Investment choices with us are very simple and appropriate for our market. We do no individual stocks, we do no options, we do no commodities, but mainly mutual funds and annuities. You can't buy Google from us, but you can buy 700 mutual funds from top companies, like Invesco and Legg Mason.

Our clients' household income is between $30,000 and $100,000 a year. There's usually two parents working in those homes, and, frankly, all too often, the homes are headed by a single mother.

We strongly believe in retirement savings, and our clients have opened 1.2 million IRAs with us. You can start one with Primerica for as little as $50 a month. Even that amount is hard to find in the families that live paycheck to paycheck. What we sometimes say is they have too much month at the end of the money.

We provide face-to-face help from licensed representatives who live and work in the communities. These representatives begin with education. They teach the fundamentals of how money works, dollar cost averaging, time in the market, emergency cash accounts. That's all important. Oliver Wyman's study, just released, found that advised individuals accumulate 38 percent more assets than the non-advised, and at age 65, they have 114 percent more.

Our clients benefit from our presence in their financial lives. A comment letter was submitted by Shelly Rosen, one of our reps. Fifteen years ago, she sat down with a railroad worker and his wife. They had a lot of debt and no savings, and they were very generous, so generous that they ran up debt on credit cards buying gifts for their friends. We helped teach them other ways to be generous. Today, they're debt free and financially independent.

The Department of Labor rule will stop Shelly Rosen from helping folks like that railroad engineer. The proposal subjects our client interactions to the prohibited transaction rules in ERISA and the IRS code, which effectively make the brokerage model, chosen by 98 percent of accounts under $25,000, illegal.

The department tried to write an exemption in their best contract exemption. It's so complex, so onerous, and so costly that it's unworkable. They attempted to make it principal-based, but instead introduced uncertainty, which makes the exemption unusable in a world of ERISA, where there is strict liability. No firm we know of intends to use it. That makes this rule more punishing than the one that was withdrawn in 2011.

In prior testimony, the Department of Labor has suggested these robo-advisors will fill the gap and help the millions stranded by the rule. We disagree. Our company believes in biorhythms, not algorithms. They need a person, not a personal computer, to navigate a financial landscape that's unfamiliar to them. Without a helping hand, they worry about a mistake, and they won't hit the send button.

In the households we serve, there is a struggle going on. It's not between Investment A or B or C. It's a fight between saving and spending, a fight to put an extra $50 away. We all agree we must act in a client's best interest. Inadequate retirement savings is the overriding issue facing the middle class, and this rule is another obstacle.

We don't doubt the DOL's good intentions. It's such an important issue, everyone needs to be involved, and we look forward to working with everyone, and we're glad the Senate is involved with this issue.

Thank you very much for listening to me.

[The prepared statement of Mr. Schneider follows:]

PREPARED STATEMENT OF PETER SCHNEIDER

Mr. Chairman, Ranking Member Franken and members of the subcommittee, my name is Peter Schneider and I am president of Primerica, Inc., headquartered in Duluth, GA. Thank you for inviting me to testify today about the U.S. Department of Labor's (Department) proposed new rules governing retirement savings investment advice (Proposed Rule). This is an issue of enormous consequence to our representatives and clients. Having access to quality help in managing household finances is critical in the middle income communities we serve.

Primerica is a leading distributor of basic savings and investment products to middle-income households throughout the United States. Our representatives educate their Main Street clients about how to better prepare for a more secure financial future. We address clients' needs through term life insurance, which we underwrite, and mutual funds, annuities and other financial products, which we distribute. We conduct our securities business through PFS Investments Inc. ("PFSI"), a registered broker-dealer and an indirect wholly-owned subsidiary of Primerica, Inc. As of December 31, 2014, Primerica insured more than 4 million lives and had over 2 million client investment accounts. This year we will pay approximately $1.2 billion in death claims to the beneficiaries of our policies and over time have assisted our clients to save about $50 billion in their accounts. Though most of these accounts are relatively small by industry standards, they are hugely important to the families who have opened them.

Primerica's typical clients are squarely situated in this country's middle class, defined by us as households with an annual income of $30,000 to $100,000, a category that represents approximately 50 percent of all U.S. households. Our business model is designed to allow us to provide exceptional client service to the middle-income families, and to do so in a sustainable manner. Our representatives are able to concentrate on the smaller-sized transactions typical of middle-income consumers. We will gladly open an Individual Retirement Account (IRA) account for an individual with as little as $250 to invest or $50 per month. We maintain over 1.2 million IRAs.

We offer investment products that are most appropriate for our middle-income clients. We offer open-end mutual funds and variable and fixed annuities, all from well-known and respected companies, as well as different savings vehicles, including non-qualified accounts, IRAs, and college savings plans. Our platform includes off-the-shelf products with commissions on par with commissions paid to other product distributors.

We are believers in educating the households we serve about fundamental financial concepts. Our investment education and philosophy is geared toward the needs of middle-income households, who often are new or less-experienced investors. In that regard, we produce easy to understand educational pieces teaching fundamental investing concepts including the critical importance of taking the steps needed to start along the path of financial security. Our primary investing principle is the long-term benefit of dollar cost averaging through systematic investing into a diversified investment portfolio. We also teach the importance of starting an investment plan early and sticking to it. The issue for our clients is time in the market, not timing the market.

At Primerica, our representatives reflect and serve the communities in which they live. Accordingly, they are well-acquainted with the financial challenges facing the middle-income households. The diversity of our sales force, which mirrors the demographics of the middle class, continues to be a primary strength of our company.[1]

This afternoon, PFSI will be filing comments in connection with the Proposed Rule. Our comments make clear that we agree that financial service firms and their representatives should act in each client's best interest and frankly that is why we believe the rules needs to be withdrawn. We respectfully submit that the Proposed Rule would cause significant harm to middle-income individuals and families by restricting their ability to save for retirement through IRAs.

We draw this conclusion first and foremost because the Department's expanded definition of fiduciary turns into a fiduciary act in almost every conversation about an IRA that a financial professional might have. ERISA and the Internal Revenue Code prohibit fiduciaries from receiving commissions and other traditional forms of variable compensation in connection with a covered benefit plan such as an IRA unless what is known as a "prohibited transaction exemption" applies and provides relief. Effectively, the DOL's expanded definition of fiduciary makes an exemption from the prohibited transactions rules necessary to continue to effectively serve individuals investing in IRAs. Unfortunately, the exemption the Department has proposed to preserve the commission-based services for IRAs—the Best Interest Contract Exemption (BIC)—is not operational.

Our concern is not the imposition of a "best interest standard." We agree that firms and their representatives should always act in their clients' best interests. In fact, we believe that acting in clients' best interests is critical to our business's long-term success. When our clients can see that they are on the path toward achieving their retirement and other goals, they are more likely to return to us and our representatives, and are more likely to refer their friends and family members to us.

Instead, our primary concern is that the requirements and uncertainties of the BIC exemption are so complex and burdensome that the exemption is neither administratively nor operationally feasible. The trouble is that, from start to finish, the BIC exemption fails to offer certainty. In operating our business, "certainty" with respect to regulatory compliance matters is critical because a failure to satisfy

[1] As of January 2013, both our sales force and our customer base are generally more diverse than the U.S. general population. Approximately half of our life insurance customers and a quarter of our securities customers are either African American or Hispanic American. Mirroring the population we serve, a slight majority of our securities customers are female.

the proposed exemption may result in steep prohibited transaction penalties, including the forfeiture of compensation and excise taxes, as well as consumer lawsuits for breaches of contract, and potentially even class action lawsuits. Critically, the technical implementation of the exemption promises to be a substantial burden, and to cause a significant disruption of services to our clients, with no true added benefits in the way of investor protections. As a result, we believe firms will not use it. Instead, they will restructure their businesses because they cannot rely on the BIC exemption.

This restructuring will mean most firms will move their commission-based brokerage IRAs to fee-based accounts, known as advisory accounts, or sometimes as "wrap accounts" or "managed accounts". Fee-based accounts typically have account minimums, usually beginning at $25,000, and the annual fees are costlier for buy and hold investors than fees associated with commission-based accounts. These higher costs for advisory accounts are due to the higher attendant legal liability, more active nature of portfolio management and greater reporting analytics provided to advisory clients. Further, these higher costs will be imposed on clients who have already determined that they neither want nor need fee-based advisory relationships. They have the choice now of one or the other or both. But 88 percent of all IRA clients, and 98 percent of the smaller ones, prefer brokerage relationships.[2]

This shift to advisory services is likely to cause millions of small balance IRA owners to lose access to the financial professional of their choice, or any at all. Those with enough investments to meet the account minimums will face higher costs and experience losses in retirement savings. These resulting losses by some estimates could be as high as $68–$80 billion each year.[3]

There is no doubt that the consequence will be negative to Main Street retirement savers, particularly to long-term buy and hold retirement investors and those with smaller accounts.

We note that our securities regulator, the Financial Industry Regulatory Authority (FINRA), recently stated that,

> "Many broker-dealers will abandon—small accounts, convert their larger accounts to advisory accounts, and charge them a potentially more lucrative asset-based fee." [4]

FINRA's Chairman and CEO, Richard Ketchum also has observed the exemption's conditions that the DOL imposes on commission-based accounts "are very narrow from the standpoint of broker-dealer activity, and don't really describe a broker-dealer model that I'm aware of from the standpoint of safe harbors." [5]

We note that this would not be the first time the DOL has put forth an exemption with conditions so impractical as to be unusable. In 2011, the Department finalized rules for the 408(g) statutory exemption that were intended to provide prohibited transactions relief for the thousands of investment fiduciaries. Though the DOL predicted that "quality, affordable expert investment advice [would] proliferate" as a result of the 408(g) exemption, to our knowledge, firms have not chosen to rely on the rule.

The reality is that Main Street consumers—families saving what they can each month—will lose access to the beneficial commission-based business services for retirement savings accounts that have benefited them so well and to their chosen financial professional. Tax-advantaged IRAs may no longer be readily available for those with less than $25,000 to invest. As the Proposed Rule only applies to qualified accounts, these households are likely to be limited to investing in non-qualified accounts, or be left with no in-person financial professional to encourage them to save at all.

For a Main Street saver, this will not be good news. Non-qualified savings accounts lack the tax advantages of IRAs, though they are preferable to not saving at all. As a result, middle-income savers will experience lower retirement savings, all else being equal. In fact, in a comment to the DOL, Compass Lexecon, one of

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[2] Oliver Wyman, *Standard of Care Harmonization: Impact Assessment for SEC* (October 2010) (stating 88 percent of investors choose commission-based services).

[3] Quantria, *Unintended Consequences: Potential of the DOL Regulations to Reduce Financial Advice and Erode Retirement Readiness*, at 29. *See also*, NERA, *Comment on the Department of Labor Proposal and Regulatory Impact Analysis*, (July 20, 2015) at 17 (finding that, based on a conservative estimate of the minimum balance for advisory accounts being $25,000, the new fiduciary standard would cause a loss of access to professional advice for 40.49 percent of retirement account holders resulting in an aggregate cost of $46 billion per year.)

[4] FINRA, Comment on Proposed Conflict of Interest Rule and Related Proposals, RIN–1210–AB32 (July 17, 2015).

[5] Waddell, Melanie, *FINRA's Ketchum Criticizes DOL Fiduciary Plan*, Think Advisor (May 1, 2015).

the world's leading economic consulting firms, reports that a median 30-year-old investor would experience a 62.6 percent greater effective tax rate relative to a Roth IRA and a 158.0 percent greater rate relative to a traditional IRA if the DOL's Proposed Rule caused him to save for retirement in a taxable savings account. Compass Lexecon provides a rough estimate that across the potentially 7.0 million households that could effectively be cut off from access to IRAs as a result of the Proposed Rule, the total reduction in retirement savings would be between $147 and $372 billion if they all opened taxable savings accounts. This calculation illustrates that the Proposed Rule may have very substantial costs which the DOL did not consider. Having one standard for individual retirement accounts and a different standard for all other individual investment accounts will create even more confusion and complexity for individuals than already exists.

The irony is that the Department is missing an opportunity to truly help middle-income families. Our experience in serving middle-income families has shown us that the issue for them is not one of conflicted advice. Rather, it is that far too many of them simply have failed to take the critical "first steps" necessary to accumulate meaningful retirement savings. The real conflict they face is between spending and saving.

Saving for retirement is for most people a hard choice, especially for people with finite disposable income, where the decision to allocate a portion of limited resources to saving often means passing on some other purchase or activity. Busy workers and families also often lack the time or confidence to navigate their finances. Yet the DOL's Proposed Rule will make it more difficult for our representatives—who are on the frontlines and living in these most affected communities—to continue to effectively educate middle-income families on the benefit of retirement saving and how to take these important steps toward retirement security.

The value that face-to-face financial assistance can bring to a household is substantial. In a recent study, Oliver Wyman[6] found that advised individuals with $100,000 or less in annual income have at least 38 percent more assets saved than non-advised individuals, and those of retirement age have more than double the assets of the non-advised. These differences translate into significant improvements in retirement living. The same study also reported that advised individuals more often display investing practices associated with long term investing success. Again, we believe that the Proposal will harm middle-income savers by unnecessarily disrupting the relationship between the client and her chosen financial professional.

In fact, the Department repeatedly, and again today, has dismissed the Proposed Rule's potential to cut off help for small savers by suggesting that self-help online investment tools—what the Department refers to as "innovation"—are a satisfactory alternative to personal help. We disagree.

Studies consistently confirm that the percent of Americans comfortable obtaining financial products online is quite low, typically below 10 percent.[7] Even younger generations strongly prefer personal interactions when it comes to retirement investing.[8]

Also troubling is that nearly 60 million Americans remain without access to online investment options,[9] and these are predominantly lower wealth families and minorities, yielding some disturbing differences that should be concerning to policymakers. Internet usage by Hispanic and African American households still lags behind white and Asian households.[10] There is also a notable geographic gap among rural versus urban households.

While we acknowledge that a computer may be immune to human self-interest, we are puzzled as to why the Department seems to believe that computer-generated

[6] Oliver Wyman, "The role of financial advisors in the US retirement market," July 6, 2015. (p.3).

[7] EBRI 2012 Retirement Confidence Survey—". . . just 10 percent of [workers and retirees] say they are comfortable obtaining advice from financial professionals online." *http://www.ebri.org/pdf/surveys/rcs/2012/EBRI_IB_03-2012_No369_RCS.pdf* (See last bullet point on page 1).

[8] Matthew Greenwald Survey—"Despite their familiarity with technology, the Generation X and Generation Y populations prefer traditional means when it comes to retirement education." "Younger Workers Want In-person Education." *http://www.benefitnews.com/news/retirement/younger-workers-want-in-person-education-2746146–1.html*.

[9] "The 60 million Americans who don't use the Internet, in six charts" *https://www.washingtonpost.com/blogs/the-switch/wp/2013/08/19/the-60-million-americans-who-dont-use-the-internet-in-six-charts/*.

[10] Pew Internet & American Life Project Surveys, March 2000-May 2013; Pew 2012 Research Report "*Digital Differences*"—20 percent of U.S. Adults Do Not Use the Internet . . . Senior citizens, Spanish-speaking adults, the disabled, the less educated, and lower earners are among the least likely to go online. Forty percent of Americans do not have broadband access at home. *http://www.pewinternet.org/2012/04/13/digital-differences/*.

recommendations, calculated without knowing the client, are in the client's "best interests" and lack bias. For example, Wealthfront asks investors five questions before its software makes a wrap account recommendation. Absent from these are questions regarding short-term liquidity needs, life cycle events, lifetime income options, employment, short- and long-term goals, need for qualified retirement savings vs. taxable investments, and a host of others personal to each family.

Unfortunately, the Department's cost/benefit analysis of the Proposed Rule failed to take into account the real-world unintended consequences we are discussing here today that can serve to substantially increase costs. Compass Lexecon, in a report it is filing with the Department, found the Department's conclusions as to the costs of the Proposal to be "fatally flawed."[11] It also determined that the Department's economic analysis of the Proposed Rule "grossly overstates the benefits it purports to measure."[12] Importantly, the Department also failed to acknowledge that the costs likely will be passed on to investors in the form of higher fees, particularly to IRA investors with account balances under $25,000.

We would like to note that among the unintended consequence could be the elimination of variable annuities as an option for IRAs. The BIC exemption does not provide a practical pathway for firms to offer variable annuities to IRAs if they also offer any other products, such as mutual funds. Variable annuities typically come with both living and enhanced death benefits. These lifetime benefits are often critical to protecting the best interests of retirement investors. During the market upheaval of the recent recession, they saved many of our clients' retirements. We are greatly concerned about the potential elimination of this important investment option for retirement investors.

As we have explained, the high cost of compliance with the Proposed Rule, and the substantial time and resources required to develop and implement the Proposed Rule, will have broad consequences by affecting the decisions firms make in responding to the rule. While we do not have time to discuss those costs in detail, we do not believe that the marginal fixes that the Department now seems open to considering will sufficiently ease those enormous burdens. For example, even if the DOL makes some adjustments to the rule such as changing the timing of when newly required contracts must be signed, those contracts would have to be prepared for new and existing clients, new systems would have to be developed and integrated (in some cases with third-parties) to create and manage new disclosures, and compliance policies and procedures would need to be updated. At our firm alone, over 80,000 representatives would need to be trained to comply with the rule. Nor would we expect the changes to resolve the numerous ambiguities within the Impartial Conduct Standards that give rise to potential forfeiture of compensation and excise taxes, as well as consumer lawsuits for breaches of contract and class action lawsuits.

In his testimony today, the Secretary drew the analogy of investment professionals to doctors and lawyers. While we agree that many people regard their financial professional highly, we think it is useful to draw the analogy out to fit the circumstances. We question what doctors or lawyers would do if faced with similar regulation. As with the financial industry, we would not expect the objections to be to the standard of care. But would doctors continue to serve patients if they were required to sign a contract guaranteeing fees and projecting results over 1, 5 and 10 years, give warranties on loosely defined standards that could be challenged by trial attorneys in hindsight, and report volumes of personal patient data, as well as their own compensation, so that it is publicly displayed? We think they would not. We also wonder whether the Department would believe that on-line medical services would be a sufficient alternative for those who were cut off from face-to-face interaction as a result of their rule.

As indicated, a possible outcome of the Proposed Rule is that nearly half of middle-income consumers—those with amounts to invest below advisory account minimums—will be left with no option to save in an IRA.[13] For many families this may result in decisions to spend rather than to save. For those who choose saving, only a few can be expected to use online investment options. The others may unknowingly forgo the tax benefits available to IRAs and instead invest through non-qualified accounts. Obviously, this would be contrary to congressional intent of encouraging retirement savings.

Overall, we believe that the Proposed Rule will harm rather than help middle-income retirement investors. The added litigation and penalty risks will drive in-

[11] Compass Lexecon, *An Evaluation of the Department-Impact Analysis of Proposed Rules Relating to Investment Advisor Fiduciary Status*, (July 20, 2015) at Par 3.
[12] *Ibid*, at Par. 33.
[13] NERA, at 28.

creased compliance costs and lead financial institutions and representatives to curtail the services they offer to those families with more limited means.

For the record, we favor a single best interest standard for all the types of accounts and clients we serve. The best policy is a best interest standard that respects the different choices broker-dealers and registered investment advisers offer Americans. In short, it is a standard that helps people save rather than one that sets up narrow guardrails in the middle of the road that effectively serve as a retirement roadblock for the middle-class.

We believe the DOL is sincere in trying to help protect investors from conflicts of interest. That is a goal we share. But the DOL lacks the tools to do the job right. The authority it has to define the word "fiduciary" is insufficient to rewrite the rules governing the entire securities industry in this area.

You should know that it will be the clients, not the companies that are hurt most by this rule. Companies are resilient, and many firms will figure out how to go upscale and focus on a new customer base. The clients are the ones who will lose most. The war being waged every day in the homes we serve—by people not robots—is where the family can find $100 a month, $50 even, to start saving for college and retirement. The real problem with the Proposed Rule is it makes what is now an extremely difficult task into an impossible one.

On behalf of Primerica's 101,000 representatives and 2,000 employees dedicated to providing a more secure financial future to our clients, I'd like to thank you for letting me share our perspectives on this critically important matter.

Senator ISAKSON. Thank you, Mr. Schneider.

Ms. Miller.

STATEMENT OF DARLENE MILLER, PRESIDENT AND CEO, PERMAC INDUSTRIES, BURNSVILLE, MN

Ms. MILLER. Thank you, Chairman Isakson and Ranking Member Franken—and thank you for the kind introduction—and members of the Subcommittee on Employment and Workplace Safety and members of the full committee. I am here representing myself and my employees and also the Chamber of Commerce, of which I am a board member, and I chair the U.S. Chamber's Small Business Council.

Permac opened in 1966, and I purchased it in 1993 and 1994 and started with seven employees. We now have almost 30, and we're looking to expand. In order to expand, my company must be able to compete with much larger companies for talented employees. One way we're able to do so is by offering employee benefits, including a retirement savings plan.

As an owner of a business, I am very focused on the details of my core business function, and I use outside professionals to help me with supplemental business functions. For example, I use a CPA to assist me with tax issues, an attorney to assist me with legal issues, and a financial advisor to help me with my retirement savings plan.

In 1999, Permac implemented a SARSEP, now known as a SEP-IRA. The plan was recommended to me by an advisor who I had worked with previously to provide medical benefits for my employees.

Several years later, my advisor advised me that I was in danger of violating the 25-employee limit for a SARSEP. At that point, I worked with him to determine how to continue to provide retirement benefits for my employees. We decided a 401(k) plan was the best option for my company, and in 2008 we implemented that plan.

We have a 96 percent enrollment rate in our plan. Almost all of our employees participate in that plan. Of the eligible ones, there is only one who is close to retirement who does not participate, and a couple that are part-time are not quite yet eligible.

Under the 401(k) plan, employees receive a matching contribution equal to 100 percent of their first 3 percent that they contribute, and then 50 percent of the next 2 percent of contributions. Also and just as important is Permac provides substantial investment education to all of its employees.

I look forward to continuing to provide competitive benefits. My current employees are like family to me, and I want to be able to help them, especially with their retirement. Just as importantly, I want to be able to attract new employees. Eighty-two percent of our association, PMPA, Precision Machined Products Association, say that they also need to be able to provide this benefit to their prospective new employees. I am very concerned that the proposed rule will impact our ability to do so.

Last week, the Chamber submitted a comment letter to the Department of Labor enumerating many ways in which the proposed rule is unworkable. In my testimony, I'd like to highlight three issues that will have a particularly negative impact in small business plans.

First, the seller's carve-out discriminates against small businesses and will decrease access to much-needed guidance. Under the proposal, there is a carve-out for the advisors that are selling or marketing materials. However, that carve-out does not apply to advisors to small businesses. The DOL seems to believe that small business owners, such as myself, are not as sophisticated as large businesses and, therefore, need additional protection.

When I work with my financial advisor, I am aware that he is providing a service for a fee and selling a product. I wouldn't be able to run a successful business if I were not able to understand when I'm involved in a sales discussion.

Second, the changes to the education carve-out will restrict access to investment education for both small business owners and their employees. My employees really truly value the investment education provided to them, specifically providing investment recommendations in various asset classes. This information allows them to make informed investment decisions, and many of my employees could not afford to pay for this investment education separately and might be discouraged from investing in the plan at all if my company did not provide this benefit.

And, third, the best interest contract exemption will increase the cost of services to small businesses and possibly eliminate access. There is some question about whether advisors to small business plans are even able to use the BIC exemption. Even assuming that they are, there are certain to be additional costs associated with these changes. As a business owner who relies on outside professionals to help me manage my plan, any additional cost imposed by the regulation will be passed on to me.

In conclusion, I'm very concerned that the proposal will not achieve the department's goals of better protecting workers and retirees but will instead make it harder for small business employers and employees to access the financial advice and increase their retirement services.

Thank you for the opportunity to testify before you today, and I look forward to any questions you might have.

[The prepared statement of Ms. Miller follows:]

PREPARED STATEMENT OF DARLENE MILLER

Thank you Chairman Isakson, Ranking Member Franken and members of the Subcommittee on Employment and Workplace Safety and members of the Senate Committee on Health, Education, Labor, and Pensions.

I am Darlene Miller, president and CEO of Permac Industries in Burnsville, MN. I am here representing the U.S. Chamber of Commerce of which I am a board member and chairperson of the U.S. Chamber Small Business Council.

Permac Industries is a precision machining manufacturer that services the global aerospace, defense, medical, high-reliability industrial and commercial industries. When I purchased Permac in 1993 there were 7 employees. We now have almost 30 employees and are looking to expand. In order to expand, my company must be able to compete with much larger companies for talented employees. One way that we are able to compete is by offering employee benefits, including a retirement savings plan. As the owner of a business, I am focused on the details of my core business function—sales, finance, and manufacturing oversight—and use outside professionals to help me with supplemental business functions. For example, I use a CPA firm accountant to assist with tax issues, attorneys to assist with legal issues, and a financial advisor to help me with my retirement savings plan.

In 1999, Permac implemented a SARSEP—a Simplified Employee Pension plan which is now known as a SEP–IRA. The plan was recommended to me by a broker whom I worked with to provide medical benefits for my employees. This broker was a trusted adviser that I had worked with previously and had provided valuable assistance. Several years later, my broker advised me that I was in danger of violating the SARSEP rules because my employee population was exceeding the 25 employee limit. At that point, I worked with him to determine how to continue to provide retirement benefits for my employees. We decided that a 401(k) plan was the best option for my company and in 2008 we implemented the new plan. Through the 401(k) plan, Permac provides the opportunity to save, a matching contribution, and investment education. There is 93 percent participation in the plan and, annually, the company provides an investment seminar. All employees—even those who don't participate in the plan—are encouraged to participate in the investment seminar.

My broker helped me implement the SARSEP, notified me when I was about to be in violation of the rules and guided my transition to a 401(k) plan. My current employees are like family and I want to be able to help them. Just as importantly, I want to be able to attract new employees. Providing retirement benefits has been important to help my current employees and to attract new employees. As my company continues to grow, I look forward to providing competitive benefits. I am very concerned that the proposed rule will prevent my ability to do so.

The Chamber has earlier submitted a comment letter to the Department of Labor enumerating many ways in which the proposed rule is unworkable. In my testimony, I would like to highlight three issues that will have a particularly negative impact on small business plans:

1. The seller's carve-out discriminates against small businesses and will decrease access to much-needed guidance.
2. The changes to the education carve-out will restrict access to investment education for both small business owners and their employees.
3. The Best Interest Contract Exemption will increase the costs of services to small businesses and possibly eliminate access.

The seller's carve-out discriminates against small businesses and will decrease access to much-needed guidance. Under the proposal, there is a carve-out for advisors that are selling or marketing materials ("Seller's Carve-Out"). However, this carve-out does not apply to advisors to small businesses. The DOL seems to believe that small business owners, such as me, are not as sophisticated as large businesses and, therefore, need additional protections. The validity of this rationale is based on faulty assumptions, and does not justify discriminatory treatment. When I work with my financial adviser, I am aware that he is providing a service for a fee and selling a product. I would not be able to run a successful business if I were not able to understand when I am involved in a sales discussion—particularly, if it follows a basic disclosure that an advisor is selling a proprietary financial product, that the advisor is paid to sell the product, and the advisor is not providing fiduciary advice. This disclosure, similar to that the Department requires in the large plan carve out, is readily understandable to any recipient.

The assumption that small plans, participants and IRA owners cannot understand the difference between sales and advice does not match my real world experience. The Department can protect participants, IRA owners and small plans with the same kind of disclosures that it requires of large plans under the large plan carve out, but without eliminating their right to choose the services and products that best fit their needs.

The changes to the education carve-out will restrict access to investment education for both small business owners and their employees. While the Proposal expressly permits education to be provided to plans, participants, and IRAs, the redefinition of asset allocation models that reference the plan's investment options as fiduciary advice will significantly disrupt plan sponsor efforts to educate their plan participants and retirees about investment options. Many small businesses, including mine, rely on trusted third parties to provide investment education to their employees. These efforts include providing asset allocation models that provide a recommendation on investments in various asset classes based on a plan participant's age, expected retirement and risk tolerance. However, under the Proposal, any party who provides specific investment options for each asset class would be deemed an ERISA fiduciary. This significant modification from current rules, which allows for such information on a non-fiduciary basis, would harm investors, and particularly small business plan participants that likely have access to fewer resources.

My employees value the investment education provided to them—specifically providing investment recommendations in various asset classes. This information allows them to make informed investment decisions. Many of my employees cannot afford to pay for investment education separately and might be discouraged from investing in the plan at all if the company did not provide this benefit. By disallowing any party to make the link between asset classes and specific investment options, the Department of Labor is forcing plan participants into the tenuous position of figuring out how to invest their own retirement savings and risk making poor choices.

The Best Interest Contract Exemption will increase the costs of services to small businesses and possibly eliminate access. Because advisors to small businesses are not carved out of the fiduciary definition, they must change their fee arrangements, or qualify for a special rule called an "exemption" in order to provide services on the same terms as before.[1] The reason the DOL regulatory package causes such significant change is that a fiduciary investment advisor under ERISA generally has engaged in a prohibited transaction if the advisor recommends investments that either pay the advisor a different amount than other investments, or that are offered by affiliates (for example, the advisor is connected with the insurance company that offers the investment). There are certain exceptions to these rules, called "prohibited transaction exemptions" but as DOL has proposed the new rules, the exemptions generally won't help financial advisors who are working with small businesses to set up plans. Therefore, it may be illegal for those advisors to get commissions or to recommend certain investments.

This problem is highlighted in services for SEP and SIMPLE IRAs. One way advisors might try to comply is by charging a flat fee for their SEP or SIMPLE IRA services. Even though Permac no longer provides a SEP–IRA, we might never have offered one if the fees had been too high. Without that introduction into providing a retirement savings program, we might not have moved onto a 401(k) plan. Consequently, it is extremely important to consider the negative impact that increased costs will have—particularly in the small business plan market.

In conclusion, for the reasons stated above, we are very concerned that the Proposal will not achieve the Department's goals of better protecting workers and retirees, but will instead make it harder for small business employers and employees to access financial advice and to increase retirement savings. I appreciate that the DOL is looking to work with the industry to resolve our concerns. However, I am very concerned that the current timeline does not allow enough time for proper discussions. If the final rule does not properly resolve the issues raised above, the unintended consequences will have substantial negative repercussions on my employees, as well as the employees of many other small businesses.

Thank you for the opportunity to testify before you today and I look forward to any questions you may have.

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[1] However, the new exemption proposed by DOL may not apply to small business plans. It does apply to individual owners of IRAs, but it is not clear whether this exemption is available for retirement plans—including SEP and SIMPLE IRAs—that are being offered by the employer. Further, even if it does apply, the new exemption—called the Best Interest Contract ("BIC") Exemption—would itself substantially increase costs for advisors due to its many conditions and requirements.

Senator ISAKSON. Thank you, Ms. Miller.

Before we go to Mr. Puritz, I want to apologize. Senator Roberts and I both have an Ethics Committee hearing which involves nobody on the dais, I might add, at 4 o'clock. We have to be there. Showing the good-natured spirit that I am and also a spirit of bipartisanship, I'm going to turn over the rest of the hearing to our acting chairman but Ranking Member, Al Franken.

Senator ROBERTS. Good grief.

Senator Franken [presiding]. Unprecedented.

[Laughter.]

Senator ROBERTS. Mr. Acting Chairman, I don't know what to say. You again.

[Laughter.]

Senator FRANKEN. May I help you? OK. This is an old Jack Benny thing. Let's just go right to Mr. Puritz.

[Laughter.]

STATEMENT OF SCOTT PURITZ, MANAGING DIRECTOR, REBALANCE IRA, BETHESDA, MD

Mr. PURITZ. Thank you, Chairman Isakson, Ranking Member Franken, and members of the subcommittee, for this opportunity to provide Rebalance IRA's views about the Department of Labor's proposed conflict of interest rules.

I'm Scott Puritz, the co-founder and managing director of Rebalance IRA. My firm is a registered investment advisor with approximately $275 million of assets under management, and we serve approximately 500 clients. Rebalance IRA is a relatively new national investment advisory firm that combines top-quality retirement expert investment advisors, real human beings, with low-cost, highly diversified retirement portfolios for everyday Americans.

Our firm's Investment Committee includes financial luminaries, Professor Burton Malkiel from Princeton; Dr. Charlie Ellis, who chaired the famed Investment Committee at the Yale Endowment; and Jay Vivian, who managed IBM's $100 billion corporate pension fund.

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

Rebalance IRA is part of a broad trend of investment advisory firms that seek to provide consumers with a fundamentally better set of retirement investment options. This new generation of firms is offering retirement investment advice to clients at all income levels for very modest fees. The group of innovators includes new firms, such as my own, Rebalance IRA; Wealthfront; and Personal Capital, but also includes established industry players such as Vanguard and Schwab.

This trend of retooling the financial service industry is about 3 years old and has met with considerable success in the marketplace. Tens of thousands of clients have switched over. This group of investment innovators is growing very fast and manages over $15 billion of client assets. Imagine what would happen if there was a level playing field. Imagine.

These investment innovators have three common features. First, we harness technology to make the process more efficient. Second, we harness new business models. And, finally, we deploy new investing vehicles, typically best-of-breed, proven, endowment-style investing portfolios of low-cost ETFs. The results are considerable—lower cost, superior asset allocation, superior investment vehicles, superior transparency, and, finally, we are building profitable, successful business models.

At Rebalance IRA, our clients seek our help because they need advice about how to manage their retirement savings and how to better understand the increasingly complex world of investment products. Our clients come from all walks of life—nurses, school teachers, plumbers, lawyers, welders, professors, police, firemen, government employees—regular Americans.

We're in the marketplace every day dealing with everyday Americans as they struggle to find the best way to manage their retirement investment savings. If you will, we see how the sausage is made, and sometimes, frequently, it is not a pretty sight. Over 30 percent of our clients come to us directly from having, for lack of a better phrase, a suboptimal relationship with a brokerage firm. At our firm, we sometimes refer to these clients as brokerage refugees.

The story we see over and over again is all too familiar: a client at a brokerage firm who is stunned to find out that their so-called trusted retirement investment advisor does not have a fiduciary responsibility. In addition, the vast majority of these clients are surprised, and shocked, to discover that there is almost always a second layer of fees at the investment management level which frequently adds 1 percent or more to the fee burden.

The brokerage refugees that we see at our firm average 2.37 percent of fees all in per year. That may not sound like a lot of money. But over several decades, that extra fee burden can eat away at over half, half of a consumer's retirement nest egg, over half.

When Rebalance IRA takes on these brokerage refugees as clients of our firm, we immediately reduce their retirement investment fee structure by an average of 68 percent. In addition, we put in place for these clients a comprehensive retirement plan, and we provide our clients with best-of-breed, endowment-style, retirement investment portfolios. And, finally, we pair all of our clients with a highly qualified, two-person—real heartbeat—retirement investing team.

American inventiveness and entrepreneurial spirit are alive and well in the financial services industry. For all consumers to reap the full benefit of this truly extraordinary surge of innovation, there needs to be three things: greater transparency; greater flow of information, particularly regarding cost; and a greater alignment of economic interests.

We believe that a regulatory level playing field will dramatically accelerate the retooling of the financial services industry and provide everyday Americans with a fundamentally cheaper and fundamentally better way to save for retirement. It's time to hold all financial professionals accountable by consistently requiring them to act in the best interest of their clients and establish a level playing field. This is what the Department of Labor's rule can do.

Americans struggling to save for a dignified retirement should no longer be subjected to the conflicts of interest that are draining their retirement investments. If the traditional brokerage firms cannot live by a simple fiduciary standard and refuse to serve modest savers, so be it. Other firms who embrace this client-first approach stand ready to help——

Senator FRANKEN. Mr. Puritz, I would ask you to wrap up.

Mr. PURITZ [continuing]. All Americans at all income levels prepare for a secure retirement.

Thank you.

[The prepared statement of Mr. Puritz follows:]

PREPARED STATEMENT OF SCOTT PURITZ

Thank you Chairman Isakson, Ranking Member Franken, and members of the subcommittee for the opportunity to provide Rebalance IRA's views about the Department of Labor's proposed Fiduciary Duty Rule.

I am the co-founder and managing director at Rebalance IRA. There, I have assembled the infrastructure and service delivery methods that bring our firm's clients sophisticated retirement investment advice and the personalized treatment offered by top-tier wealth management firms, for a fraction of the cost. I also am a longtime member of the board of directors of the North Carolina Outward Bound School, sitting on its Finance Committee, which oversees the School's $14 million endowment. In addition, I helped establish an Outward Bound scholarship program for inner-city teens, giving them the opportunity to develop critical life skills. I received my B.A. in economics, with distinction, from Tufts University, and an M.B.A. from Harvard Business School. I am a registered Investment Representative and I hold a Series 65 securities license.

Rebalance IRA is a registered investment advisor firm with approximately $275 million AUM, and serves more than 500 clients. It is a relatively new, national investment advisory firm that combines top-quality retirement expert investment advisors with low-cost, highly diversified retirement portfolios for everyday Americans. Our firm's Investment Committee includes Professor Burton Malkiel (Princeton University), Dr. Charles Ellis (who chaired the Investment Committee of the famed Yale Endowment), and Jay Vivian (who managed IBM's $100+ billion corporate pension fund). Our firm embraces a fiduciary legal standard, always putting the interest of our clients front and center. We provide retirement investment advice without commissions and without conflicts between our interests and those of our clients.

Rebalance IRA is part of a broad trend of new investment advisory firms that seek to provide consumers with a fundamentally better set of retirement investment options, offering retirement investment advice to clients at all income levels for very modest fees. This trend of disrupting the established investing order is about 3 years old and has met considerable success in the marketplace. Tens of thousands of clients have switched over to firms like ours from brokerage firms and others. These "investment innovators" are growing quickly, and, by some measures, to date this group of firms collectively manages more than $15 billion in client assets.

I would like to share the Rebalance IRA perspective on the Department of Labor's proposed update to its fiduciary duty rule, discussing our clients' experiences, the problem in the retirement investment advice industry, the need for an updated fiduciary duty rule, and our firm's business model.

WHO WE SERVE

At Rebalance IRA, our clients seek our help because they need advice about how to manage their retirement savings and how to understand the increasingly complex world of investment products. Our clients come from all walks of life including nurses, school teachers, plumbers, lawyers, welders, professors, police, doctors, farmers, government employees—i.e., regular Americans.

We are in the marketplace every day, dealing with everyday Americas as they strive to find the best way to manage their retirement investing savings. We see firsthand the shortcomings of the current regulations governing advice given to retirement savers.

I would like to begin by telling a story about one of our clients, and her experience with conflicted advice. She is a 37-year-old woman from California, married with three children. In managing her family's retirement investments, she had "inherited" a stockbroker from her family. She used this broker for some time, believing she was only paying the typical 1 percent fee for investment advice and entrusted him with her family's retirement nest egg.

Later she was introduced to Rebalance IRA, and reached out to learn more about our firm's services. Upon our review of her retirement investment statements, we found that her broker had invested her retirement funds in actively managed mutual funds, which contained a significant second level of fees. In addition, her stockbroker had recommended a new actively managed mutual fund, with a front-end load that took 5 percent off the top. When all was said and done, she was paying over 2.3 percent in annual fees, not the typical 1 percent. What's worst—she had no idea. Her broker never disclosed the fees or conflicts to which her accounts were subject. In the end, Rebalance IRA was able to reduce the annual "all-in" cost for this client's retirement accounts by nearly 70 percent, or by over $5,000 per year. We also invested her funds in a more appropriate diversified set of retirement investment portfolios and implemented a disciplined risk management rebalancing system.

This client isn't alone. In fact, more than 30 percent of the Rebalance IRA client base comes to our firm directly following a "suboptimal" relationship with a brokerage firm. We refer to these clients as "*brokerage refugees*." Just like her, these clients usually are shocked to find out that their "trusted" retirement investment advisor does not have a fiduciary obligation. In addition, these *brokerage refugees* consistently are surprised to discover that the investments in their retirement accounts frequently are burdened with a second level of fees at the investment vehicle level or fund-level fees. The *brokerage refugees* that we see at our firm average over 2.37 percent per year of total (all-fee) fees in their brokerage retirement accounts.

It is important to keep in mind that, as with investment returns, investment fees compound over time and can eat away at retirement savings. While 2.37 percent per year may not sound like a large amount of money, over several decades this increasingly compounding fee burden can reduce a consumer's retirement nest egg by half if not more.

When Rebalance IRA takes on these *brokerage refugees* as clients of our firm, we immediately reduce their retirement investing fee structure by an average of 68 percent. In addition, our firm provides meaningful retirement investment advice to all of our clients. Rebalance IRAs' advisors put in place a comprehensive retirement investing plan, and we provide our clients with best-of-breed, endowment-grade, low-cost retirement investment portfolios. And finally, we pair all of our clients with a highly qualified, two-person retirement investing team.

THE HEART OF THE PROBLEM

The lack of a consistent best interest advice is at the heart of the debate that we are having today. We have seen it firsthand, and we are troubled that others in the advisory industry are *legally* allowed to act in this manner, sometimes putting their own interest, or their firm's, ahead of their clients.

Consumers that we see typically thought that their investment advisor was acting in their best interest, which studies have supported. One study found 49 percent of investors assumed that investment advisors were required to act under a fiduciary standard, while 59 percent believed "financial advisors or financial consultants" had the same requirement.[1] Inconsistent and weaker standards should not be the norm for retirement savers, yet they are.

The current rules governing the standards for investment advice under the Employee and Retiree Income Security Act (ERISA) are outdated and filled with shortcomings and loopholes. These rules, first promulgated 40 years ago in 1975, were written when the retirement landscape consisted primarily of defined benefit plans, also known as traditional pensions. At that time IRAs had just been created a year prior and 401(k)s had yet to exist. Advice was not something that was in demand, because pensions were managed professionally for employees through their employer.

Today, that is not the case. Plans available to workers and retirees are dominated not by pensions, but by defined contribution plans such as 401(k)s and IRAs. These plans require workers and retirees to invest their savings on their own, yet many lack the level of expertise necessary to properly manage their retirement savings. This is why we are here—and why many others are in this industry—to specialize in providing people with advice necessary to invest and manage their retirement savings.

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[1] ANGELA HUNG, ET AL., INVESTOR AND INDUSTRY PERSPECTIVES ON INVESTMENT ADVISERS AND BROKER-DEALERS 89 (2008).

Unfortunately, the "help" many receive often is not in their best interest. The 40-year-old rules allow brokers, insurance agents, and others offering retirement investment advice to put their own interest ahead of their clients. The investment products sold to retail investors can generate attractive commissions for these firms, yet has the potential to leave clients with underperforming investments and layers of fees.

THE SOLUTION

The Department of Labor has proposed a "fiduciary rule" requiring all financial professionals to avoid and mitigate conflicted advice when it comes to retirement investments. The proposed rule would better cover advice largely unprotected today—especially in the $7 trillion individual retirement account (IRA) market. Expectedly, this has generated strong opinions on both sides of the issue, with a portion of the advisory industry who provide conflicted advice endeavoring to make this much-needed rule update a difficult battle.

Rebalance IRA strongly supports the proposed rule because it successfully follows a fiduciary standard that we feel investors and firms across the board should embrace. Committing to a best interest standard can be done, and it should be done, because American workers and retirees deserve advice given in their best interest.

Rebalance IRA provides retirement investment advice without commissions and without conflicts, which allows our firm to put each of our clients front and center. That is why we find it troubling that many who label themselves as financial advisors find this standard a difficult one to adopt, call the rule "unworkable," and claim that they are for a best interest standard without willing to commit to one at the end of the day. Unfortunately, this segment of the advice industry defends the status quo.

Millions of hardworking Americans simply want to be sure that they can make ends meet during their golden years. The Labor Department's proposed rule would give them the chance to do that by requiring those giving retirement investment advice to act in the best interest of their clients and comply with the fiduciary standard already embraced by Rebalance IRA and other investment innovators. A universal fiduciary standard, combined with full and fair disclosure, will help consumers make truly informed decisions about how best to manage their retirement investments.

OUR BUSINESS MODEL WORKS

Currently, many brokerage firms and others providing retirement investment advice outside of a fiduciary standard are structured to maximize the sale of investment "products" and maximize profits, regardless of the implications for their clients. Often, they claim that small savers and small businesses will be the ones who lose out on the retirement investment advice that they need. Yet this ignores the fact that what small savers often get from brokers is not true advice, but rather a sales pitch disguised as advice. And, because retail investors by and large are not financial experts, they often cannot tell the difference between the two and, as a result, are susceptible to suffering harm from the recommendations they receive. Industry claims that small savers and small businesses will lose out on retirement investment advice also ignore the ever-growing options available today for individuals.

Rebalance IRA and other investment innovators such as Wealthfront, Personal Capital, and Financial Engines, are striving to provide retirement investors with fundamentally different and better investing options. Established industry companies, such as Vanguard and Schwab, are joining in this movement to find innovative ways to deliver high-quality, low-cost options to retirement savers to make the best of their nest egg.

This investment innovation trend already is delivering tangible benefits to consumers. For example, at Rebalance IRA our services are 50–75 percent lower than traditional brokerage models. It must be noted that costs are the most accurate predictor of investment success over time. The second predictor of success is asset allocation. At Rebalance IRA, our highly skilled financial advisors spend considerable time with new clients to strive for the optimal balance of risk and reward, unbiased by commissions. Third, our firm provides a high level of transparency, regarding "all-in" investing costs to consumers and fiduciary responsibilities to clients. And finally, we pair all of our clients with a highly qualified, two-person retirement investing team. Put together, this has resulted in a business model that is successful for investors, as well as profitable. *Bottom line: Advisors can provide best interest advice to investors of all incomes and run a successful business.*

Because our firm runs free of conflicts, we do not have concerns about litigation. We believe that when we put our clients front and center, without conflict, and provide them with high caliber services under our business model, we can leave concerns about regulatory risk at the door. We take our fiduciary obligation seriously, just as any advisor should, and that results in relief from worries of legal costs.

CONCLUSION

It is time to hold all financial professionals accountable by consistently requiring them to act in the best interests of their clients, and establish a level playing field. That is what the Department of Labor's rule can do. Americans struggling to save for a dignified retirement should no longer be subjected to the conflicts of interest that are draining their retirement investments. And, if traditional brokerage firms cannot live with the simple fiduciary standard and refuse to serve modest savers, so be it. Other financial firms who embrace the client-first approach, new and established, stand ready to help all Americans prepare for a secure retirement.

Thank you again for the opportunity to appear before you today. I look forward to answering your questions.

Senator FRANKEN. Thank you. Since I'm, I guess, the acting chairman now, I will be here until the end. I'll go to Senator Warren to ask her questions.

Senator WARREN. Thank you, Mr. Acting Chairman. As we have discussed, it is now perfectly legal for retirement advisors to give advice that boosts their own incomes by selling lousy products to their clients. According to the best available data, data that are not paid for by the industry, this bad advice costs Americans about $17 billion a year. The Department of Labor has proposed a rule that would put a stop to this retirement savings drain and require all investment advisors to put their customers first—a level playing field.

Mr. Schneider, you're the CEO of Primerica, a large investment advisory firm, and you've testified today that the Department of Labor's rule is—and I think these are your words—complex and burdensome, and you said that one thing that's "critical" to your success is that Primerica always operates in its clients' best interests.

I was interested to read a news report this morning that outlines lawsuits brought against your advisors in Florida. According to the article, at least 238 firefighters, teachers, and other career public workers who were near retirement age accused your company of providing bad advice that drained their retirement savings. You did it by advising them to move their retirement savings out of a guaranteed government pension into riskier private investments.

Primerica was poised to make a lot of money, but only if you could convince Florida firefighters who were near retirement age to cash out their guaranteed pensions. Mr. Schneider, I just want to understand your company's advice in these cases. Do you believe that people like these firefighters from Florida who are near retirement and have secure pensions with guaranteed monthly payments should move their money into riskier assets with no guarantees just before they retire?

Mr. SCHNEIDER. First of all, Senator Warren, I appreciate the promotion. I'm actually the president of the company, not the CEO.

Senator WARREN. Oh, OK.

Mr. SCHNEIDER. I'm familiar with the matter of which you speak, and it doesn't have any application, actually, to the rule before the committee, because in that particular case, none of those individuals were clients of Primerica.

Senator WARREN. Whoa, whoa, whoa.

Mr. SCHNEIDER. They paid us no compensation. Let me go to——

Senator WARREN. No, no. Let's just stop right there, Mr. Schneider. The article didn't say the workers were your retirement clients. It says you gave them bad advice, and here exactly is the quote.

> "Once these workers retired and moved out of their government plans, Primerica agents stood to profit from managing their retirement assets. Had they stayed in the pension programs, retirees would have simply collected their monthly payments, leaving nothing for Primerica to manage and no commissions for Primerica agents to harvest."

My question is not how you were paid. My question is whether you think it is sound investment advice to encourage public employees to move their money out of their pensions and into riskier assets with no guarantees just before they retire.

Mr. SCHNEIDER. Senator, in that particular matter, first of all, regulators looked at that. They found the firm had acted properly, and the case was dismissed by the court.

Senator WARREN. Let me stop you right there. The question about the regulators is the question about is it legal to do that, and that's exactly the problem we've got. It is legal to do that, and I think that's what the regulators say. It's legal.

My question, once again, is about the advice that Primerica agents gave. Is it a good idea for firefighters on the front edge of retirement to move out of a guaranteed benefit plan that was going to cover them for all their lives and move into a risky investment that would make a lot of fees for your agents?

Mr. SCHNEIDER. Each situation is really very different. If you are in a defined benefit plan, and you're sick, what happens is in the State of Florida, for example, were you to retire and then die 2 or 3 weeks later, you have no ability to leave your money to your loved ones.

Senator WARREN. I'm sorry. Are you suggesting that these 238 people were weeks away from dying and that's why they all got this advice?

Mr. SCHNEIDER. Senator, the courts dismissed those cases, and, frankly, this illustrates one of the problems——

Senator WARREN. Because it is legal activity. I think we've established that, Mr. Schneider, that no one broke the law. The question is whether the law should be changed.

Mr. SCHNEIDER. It illustrates one of the issues, though, with the rule, because we're here to talk about the rule. One problem with the rule is, as everyone in the financial services industry knows, especially after the financial crisis, you can be sued, sometimes appropriately, but also sometimes frivolously.

Under the best interest contract exemption, you enter into a contract with the client, and they can sue you, and you can lose the benefit of the exemption. It's not just a contract——

Senator WARREN. I understand, Mr. Schneider, that you don't want to be sued. I totally get that. The question I keep trying to ask is whether it's generally a good idea for workers like firefighters and teachers on the eve of their retirement to move their money from guaranteed defined benefit plans into riskier investments.

Let me ask you that question, Mr. Puritz. You're the managing director of Rebalance IRA. You have a large investment management firm. Would you advise 50-year-old, 60-year-old clients to cash out of a defined benefit pension plan and move money into an IRA managed by your company?

Mr. PURITZ. As a general rule, the answer is no.

Senator WARREN. So you'd say no. Why not?

Mr. PURITZ. In a traditional pension, a defined benefit plan, there's safety and predictability. My answer would be different if it was a defined contribution plan.

Senator WARREN. That's not what we have here. We have a defined benefit plan that guarantees that these people are going to be covered for their entire lives. Is that right? There's a lot of research around this, I understand. Are there circumstances in which it is a good idea for someone right on the threshold of retirement to move from a defined benefit plan that will protect them for the rest of their lives to a much riskier plan?

Mr. PURITZ. There are circumstances, but they're very rare.

Senator WARREN. You would describe them as very rare. I must say I took a look at the research on this and wanted to get some more experts' opinions on this. It seems to me the research is pretty clear.

Alicia Munnell, the director of the Center for Retirement Research at Boston College, has said,

> "Only those with serious illnesses who believe they do not have much time left should even consider cashing out a defined benefit pension,"

and even that isn't obvious, because, as she puts it, even sick people may live longer than they think.

Mr. Puritz, let me ask you one more question. Do you think it is—and I want to use the correct quote here—"complex and burdensome" to offer advice that is in the best interest of the client, as Primerica claims?

Mr. PURITZ. No.

Senator WARREN. I didn't think so. Frankly, the suggestion that it's too expensive to provide people with sound financial advice is ridiculous. Millions of financial advisors do it every day. Hardworking Americans like the Florida firefighters and teachers who devoted their careers to protecting the public and who were targeted by Primerica shouldn't have to worry about whether their financial advisors are planning to get rich by playing roulette with their customers' retirement savings.

Hardworking advisors, like Mr. Puritz, shouldn't have to compete with these schemes. I am glad the Department of Labor is working to fix this problem.

Thank you, Mr. Chairman.

Senator FRANKEN. Thank you, Senator.

Mr. Puritz, in both your spoken testimony and your written testimony, you referred to something called a brokerage refugee. I think that's someone who fled a brokerage and had a bad experience, I guess, right?

Mr. PURITZ. That's right.

Senator FRANKEN. OK. You mentioned in your written testimony a married 37-year-old mother of three who was paying excessive fees on a new mutual fund recommended by a broker she inherited from her family. How do the services you provide and the fees you charge under your duty as a fiduciary differ from those that this woman experienced with her inherited broker?

By that—it was that her family had been using this broker for years or something. What does that mean for retirement investors' nest egg or their ability to retire after, say, 30 years of working and saving?

Mr. PURITZ. Senator, that's a great question. It really gets to the heart of the issue——

Senator FRANKEN. She literally means raising the microphone to your lips or to your mouth, not to your lips, but——

Mr. PURITZ. How's that? Is it on?

Senator FRANKEN. Thank you. There we go.

Mr. PURITZ. Senator, thank you. That's an excellent question, and it really gets to the heart of this matter from an economic point of view, from a return point of view. In the example that we cited of a client, we're talking about an extra fee burden.

Charlie Ellis, who is a member of our Investment Committee, has a phrase he says, that "the dirtiest word in finance is only," only 1 percent. We think of 1 percent as—what's the big deal? We pay 15 percent for tips, 20 percent if you're generous. One percent seems inconsequential.

In the scenario that we've run into consistently with clients who come from brokerage relationships, that extra fee burden is 2.37 percent. If you trend line that out over 30 years——

Senator FRANKEN. That's additional, or that's what they're paying?

Mr. PURITZ. That's what they're paying per year.

Senator FRANKEN. OK. I got it.

Mr. PURITZ. In the current environment with plenty of good lower-cost alternatives, it's really an unnecessary fee burden.

Senator FRANKEN. Isn't that essentially—that's compounded? Is that the——

Mr. PURITZ. Fees compound just like return, exactly, Senator. I'll give you an example. If someone had $100,000, and they were in an all growth stock, which historically has returned—our magic number is 7.2 percent a year. At that number, in a tax deferred account, that account would double every 10 years. In the 30-year timeframe, $100,000 would become $800,000—real considerable wealth creation.

By contrast, if you reduce that down to 5 percent, which is really the fee delta that we see in the marketplace, that $100,000 only grows to $400,000 or half the amount of money. That's what's at stake here. It's about a doubling of the return.

Senator FRANKEN. OK. How are you able to provide your service at such a lower—my computations—32 percent of 2.37 percent is about .75 percent.

Mr. PURITZ. That's correct.

Senator FRANKEN. How do you do that?

Mr. PURITZ. We use technology to make everything we do more productive. We use exclusively low-cost ETFs, index funds——

Senator FRANKEN. Is that what was called, disparagingly, I think, robo?

Mr. PURITZ. Robo is a phrase for a new generation of investment advisors who use technology. There are some advisors who are 100 percent computerized, and that's where the term, robo, comes from. There are some very successful ones, including Wealthfront—that is the market leader—and they're really targeting millennials and people in their 20s and 30s, for whom——

Senator FRANKEN. They're familiar with working——

Mr. PURITZ. They're familiar with computers, and their retirement is a relatively small part of their overall life. Their whole career is ahead of them.

By contrast, there's other firms, such as Personal Capital and my own firm, Rebalance IRA, where we have similar investment philosophies and similar use of technology, but we have real live investment advisors who deal extensively with clients and match them with the right asset allocation, low-cost underlying portfolios, very low-cost, and disciplined rebalancing, which is really an essential risk management and return tool.

Senator FRANKEN. I have a lot of questions, but I'll submit them for the record.

We'll keep this open—I would imagine—I didn't come here thinking I would adjourn this. When I say we'll keep it open—for a certain period of time. Is that 10 days? Ten business days. I was right. I was in the majority on one point.

[Laughter.]

Thank you all for your testimony, and this hearing is adjourned.

[Additional Material follows.]

ADDITIONAL MATERIAL*

DOL Fact Sheet—Employee Benefits Security Administration, U.S. Department of Labor

Department of Labor Proposes Rule to Address Conflicts of Interest in Retirement Advice, Saving Middle-Class Families Billions of Dollars Every Year

"Today, I'm calling on the Department of Labor to update the rules and requirements that retirement advisors put the best interests of their clients above their own financial interests. It's a very simple principle: You want to give financial advice, you've got to put your client's interests first."—President Barack Obama, February 23, 2015

Summary of Today's Action to Protect Retirement Savers By the Department of Labor

Today, the Department of Labor issued a proposed rulemaking to protect investors from backdoor payments and hidden fees in retirement investment advice.

- **Backdoor Payments & Hidden Fees Often Buried in Fine Print Are Hurting the Middle Class:** Conflicts of interest cost middle-class families who receive conflicted advice huge amounts of their hard-earned savings. Conflicts lead, on average, to about 1 percentage point lower annual returns on retirement savings and $17 billion of losses every year.
- **The Department of Labor is protecting families from conflicted retirement advice.** The Department issued a proposed rule and related exemptions that would require retirement advisers to abide by a "fiduciary" standard—putting their client's best interest before their own profits.
- **The Proposed Rule Would Save Tens of Billions of Dollars for Middle Class and Working Families:** A detailed Regulatory Impact Analysis (RIA) released along with the proposal and informed by a substantial review of the scholarly literature estimates that families with IRAs would save more than $40 billion over 10 years when the rule and exemptions, if adopted as currently proposed, are fully in place, even if one focuses on just one subset of transactions that have been the most studied.
- **The Administration Welcomes Feedback:** The issuance of a notice of proposed rulemaking and proposed exemptions begins a process of seeking extensive public feedback on the best approach to modernize the rules of the road on retirement advice and set new standards, while minimizing any potential disruption to the many good practices in the marketplace. The proposal asks for comments on a number of important issues. We look forward to hearing from all stakeholders. Any final rule and exemptions will reflect this input.

Middle class economics means that Americans should be able to retire with dignity after a lifetime of hard work. Loopholes in the retirement advice rules have allowed some brokers and other advisers to recommend products that put their own profits ahead of their client's best interest, hurting millions of America's workers and their families.

A system where firms can benefit from backdoor payments and hidden fees often buried in fine print if they talk responsible Americans into buying bad retirement investments—with high costs and low returns—instead of recommending quality investments isn't fair. A White House Council of Economic Advisers analysis found that these conflicts of interest result in annual losses of about 1 percentage point for affected investors—or about $17 billion per year in total. To demonstrate how small differences can add up: A 1-percentage point lower return could reduce your savings by more than a quarter over 35 years. In other words, instead of a $10,000 retirement investment growing to more than $38,000 over that period after adjusting for inflation, it would be just over $27,500.

In February, the President directed the Department of Labor to move forward with a proposed rulemaking to require retirement advisers to abide by a "fiduciary" standard—putting their client's best interest before their own profits. Today, the Department of Labor is taking the next step toward making that a reality, by issuing

*Due to the high cost of printing, the White House Counsel of Economic Advisors (CEA) report: The Effects of Conflicted Investment Advice on Retirement Savings to be included for the record can be found at: *https://www.whitehouse.gov'sites/default/files/docs/cea__coi__report__final.pdf*.

a Notice of Proposed Rulemaking (NPRM) to require that best interest standard across a broader range of retirement advice to protect more investors.

Today's proposal is the result of years of work and reflects feedback from a broad range of stakeholders—including industry, consumer advocates, Congress, retirement groups, academia, and the American public. The proposal includes broad, flexible exemptions from certain obligations associated with a fiduciary standard that will help streamline compliance while still requiring advisers to serve the best interest of their clients.

In the coming months, the Administration welcomes comments on the proposal and looks forward to working with all stakeholders to achieve the commonsense goals of the rule while minimizing disruptions to the many good practices in industry. Many advisers already put their customers' best interest first. They are hardworking men and women who got into this work to help families achieve retirement security. They deserve a level playing field, and their clients deserve the quality advice that this rule will ensure.

UPDATING OUR OUTDATED RETIREMENT PROTECTIONS

Since 1974, the Employee Retirement Income Security Act (ERISA) has provided the Department of Labor (DOL) with authority to protect America's tax-preferred retirement savings, recognizing the importance of consumer protections for a basic retirement nest egg and the significant tax incentives provided to encourage Americans to save for retirement. The basic rules governing retirement investment advice have not been meaningfully changed since 1975, despite the dramatic shift in our private retirement system away from defined benefit plans and into self-directed IRAs and 401(k)s. That shift means good investment advice is more important than ever. Today, DOL is proposing a new rule that will seek to:

- **Require more retirement investment advisers to put their client's best interest first, by expanding the types of retirement investment advice covered by fiduciary protections.** Today large loopholes in the definition of retirement investment advice under outdated DOL rules expose many middle-class families, and especially IRA owners, to advice that may not be in their best interest. Under DOL's proposed definition, any individual receiving compensation for providing advice that is individualized or specifically directed to a particular plan sponsor (e.g., an employer with a retirement plan), plan participant, or IRA owner for consideration in making a retirement investment decision is a fiduciary. Such decisions can include, but are not limited to, what assets to purchase or sell and whether to rollover from an employer-based plan to an IRA. The fiduciary can be a broker, registered investment adviser, insurance agent, or other type of adviser (together referred to as "advisers" here). Some of these advisers are subject to Federal securities laws and some are not. Being a fiduciary simply means that the adviser must provide impartial advice in their client's best interest and cannot accept any payments creating conflicts of interest unless they qualify for an exemption intended to assure that the customer is adequately protected. DOL's regulatory impact analysis estimates that the rule and related exemptions would save investors over $40 billion over 10 years, even if one focuses on just one subset of transactions that have been the most studied. The real savings from this proposal are likely much larger as conflicts and their effects are both pervasive and well-hidden.
- **Preserve access to retirement education.** The Department's proposal carefully carves out education from the definition of retirement investment advice so that advisers and plan sponsors can continue to provide general education on retirement saving across employment-based plans and IRAs without triggering fiduciary duties.

As an example, education could consist of general information about the mix of assets (e.g., stocks and bonds) an average person should have based on their age, income, and other circumstances, while avoiding suggesting specific stocks, bonds, or funds that should constitute that mix. This carve-out is similar to previously issued guidance to minimize the compliance burden on firms, but clarifies that references to specific investments would constitute advice subject to a fiduciary duty.

- **Distinguish "order-taking" as a non-fiduciary activity.** As under the current rules, when a customer calls a broker and tells the broker exactly what to buy or sell without asking for advice, that transaction does not constitute investment advice. In such circumstances, the broker has no fiduciary responsibility to the client.
- **Carve out sales pitches to plan fiduciaries with financial expertise.** Many large employer-based plans are managed by financial experts who are themselves fiduciaries and work with brokers or other advisers to purchase assets or construct a portfolio of investments that the plan offers to plan participants. In such circumstances, the plan fiduciary is under a duty to look out for the participants'

best interest, and understands that if a broker promotes a product, the broker may be trying to sell them something rather than provide advice in their best interest. Accordingly, the proposed rule does not consider such transactions fiduciary investment advice if certain conditions are met.

• **Lead to gains for retirement savers in excess of $40 billion over the next 10 years,** even if one focuses on just one subset of transactions that have been the most studied, according to the regulatory impact analysis released with the NPRM. These gains would be particularly important for the more than 40 million American families with more than $7 trillion in IRA assets, as advice regarding IRA investments is rarely protected under the current ERISA and Internal Revenue Code rules. Moreover, hundreds of billions of dollars are rolled over from plans to IRAs every year. Consumers are especially vulnerable to bad advice regarding rollovers because they represent such a large portion of their savings and because such transactions are also rarely covered under the current rules.

COMPLYING WITH THE PROPOSED RULE

At present, individuals providing fiduciary investment advice to employer-based plan sponsors and plan participants are required to act impartially and provide advice that is in their client's best interest. Under ERISA and the Internal Revenue Code, individuals providing fiduciary investment advice to plan sponsors, plan participants, and IRA owners are not permitted to receive payments creating conflicts of interest without a prohibited transaction exemption (PTE). Drawing on comments received and in order to minimize compliance costs, the proposed rule creates a new type of PTE that is broad, principles-based and adaptable to changing business practices. This new approach contrasts with existing PTEs, which tend to be limited to much narrower categories of specific transactions under more prescriptive and less flexible conditions. The "best interest contract exemption" will allow firms to continue to set their own compensation practices so long as they, among other things, commit to putting their client's best interest first and disclose any conflicts that may prevent them from doing so. Common forms of compensation in use today in the financial services industry, such as commissions and revenue sharing, will be permitted under this exemption, whether paid by the client or a third party such as a mutual fund. To qualify for the new "best interest contract exemption," the company and individual adviser providing retirement investment advice must enter into a contract with its clients that:

• **Commits the firm and adviser to providing advice in the client's best interest.** Committing to a best interest standard requires the adviser and the company to act with the care, skill, prudence, and diligence that a prudent person would exercise based on the current circumstances. In addition, both the firm and the adviser must avoid misleading statements about fees and conflicts of interest.

These are well-established standards in the law, simplifying compliance.

• **Warrants that the firm has adopted policies and procedures designed to mitigate conflicts of interest.** Specifically, the firm must warrant that it has identified material conflicts of interest and compensation structures that would encourage individual advisers to make recommendations that are not in client's best interests and has adopted measures to mitigate any harmful impact on savers from those conflicts of interest. Under the exemption, advisers will be able to continue receiving common types of compensation.

• **Clearly and prominently discloses any conflicts of interest, like hidden fees often buried in the fine print or backdoor payments, that might prevent the adviser from providing advice in the client's best interest.** The contract must also direct the customer to a Web page disclosing the compensation arrangements entered into by the adviser and firm and make customers aware of their right to complete information on the fees charged.

In addition to the new best interest contract exemption, the proposal proposes a new, principles-based exemption for principal transactions and maintains or revises many existing administrative exemptions. The principal transactions exemption would allow advisers to recommend certain fixed-income securities and sell them to the investor directly from the adviser's own inventory, as long as the adviser adhered to the exemption's consumer-protective conditions.

Finally, the proposal asks for comment on whether the final exemptions should include a new "low-fee exemption" that would allow firms to accept payments that would otherwise be deemed "conflicted" when recommending the lowest-fee products in a given product class, with even fewer requirements than the best interest contract exemption.

STRENGTHENING ENFORCEMENT OF CONSUMER PROTECTIONS

Existing loopholes mean that many retirement advisers do not consider themselves fiduciaries. As a result, consumers have limited, if any, recourse under ERISA and the Internal Revenue Code if their retirement adviser recommends products that are in the adviser's interest rather than the consumer's. The proposal will not only make more advisers fiduciaries but also ensure they are held accountable to their clients if they provide advice that is not in their client's best interest, because:

- **DOL currently has the right to bring enforcement actions against fiduciary advisers to plan sponsors and participants who do not provide advice in their client's best interest.** As under current law, the plan sponsor or plan participant harmed by the bad advice can also bring their own action.
- **The "best interest contract exemption" allows customers to hold fiduciary advisers accountable for providing advice in their best interest** through a private right of action for breach of contract. In other words, if an adviser isn't putting their client's interest first, the client can take action to hold them accountable. This option is especially important for advice regarding IRA investments because otherwise neither DOL nor the saver who is harmed can hold the adviser accountable for the losses the saver suffered. The contract can require that individual disputes be handled through arbitration but must give clients the right to bring class action lawsuits in court if a group of people are harmed. This feature of the best interest contract exemption is modeled on the rules under FINRA, which is a non-governmental organization that regulates advice by brokers to invest in securities but not other types of retirement savings covered by ERISA.
- **The IRS can impose an excise tax on transactions based on conflicted advice** that is not eligible for one of the many proposed exemptions. As under current law, the Internal Revenue Code imposes an excise tax and can require correction of such transactions involving plan sponsors, plan participants and beneficiaries, and IRA owners.

PROCESS GOING FORWARD

The Administration invites stakeholders from all perspectives to submit comments during the 75-day notice and comment period or through the public hearing to be scheduled shortly after the close of the initial public comment hearing. The public record will be reopened for comment after the public hearing is held. Only after reviewing all the comments will the Administration decide what to include in a final rule—and even once the Department of Labor ultimately issues a final rule, it will not go into effect immediately.

HOW IS THIS RULE DIFFERENT FROM THE PROPOSAL IN 2010?

In 2010, DOL put forward a proposal to require more retirement investment advice to be in the client's best interest. While many championed the goals of the proposal, some stakeholders expressed concerns during the notice and comment period and at a public hearing.

Mindful of these criticisms, and wanting to arrive at the right answer, DOL decided to withdraw the rule and go back to the drawing board. Since 2011, both DOL and the White House have engaged extensively with stakeholders, meeting with industry, advocates, academics—anyone who can help us figure out the best way to craft a rule that adequately protects consumers and levels the playing field for the many advisers doing right by their clients, while minimizing compliance burdens.

The proposal released today has improved upon the 2010 version in a number of ways, both in process and substance:

- **DOL has improved the process to better incorporate stakeholder feedback.**
  - **DOL is issuing proposed exemptions simultaneous with the proposed rule.** Responding to comments received in 2010, DOL is publishing the proposed exemptions alongside the rule so interested parties have a better sense of how the fiduciary requirements and exemptions work together.
  - **DOL has consulted extensively with the Securities and Exchange Commission (SEC) and other Federal stakeholders.** Secretary Perez and Chair White have had numerous meetings and conversations, and SEC staff has provided technical assistance and will continue these discussions.
  - **DOL is releasing a more rigorous analysis of the anticipated gains to investors and costs of the rule.** Since 2010, the body of independent research on the costs and consequences of conflicts of interests in retirement investment advice has grown significantly. Today, DOL is releasing a Regu-

latory Impact Analysis (RIA) alongside the rule that reflects that substantial body of research and estimates the gains to investors and costs of the proposed rule.

• **The rule's substance has changed based on comments received since 2010. Specifically, the proposal:**

- **Provides a new, broad, principles-based exemption that can accommodate and adapt to the broad range of evolving business practices.** Industry commenters emphasized that the existing exemptions are too rigid and prescriptive, leading to a patchwork of exemptions narrowly tailored to meet specific business practices and unable to adapt to changing conditions. Drawing on these and other comments, the best interest contract exemption represents an unprecedented departure from the Department's approach to PTEs over the past 40 years. Its broad and principles-based approach is intended to streamline compliance and give industry the flexibility to figure out how to serve their client's best interest.
- **Includes other new, broad exemptions.** For example, the new principal transactions exemption also adopts a principles-based approach. DOL is asking for comments on whether the final regulatory package should include a new exemption for advice to invest in the lowest-fee products in a given product class, that is even more streamlined than the best interest contract exemption.
- **Includes a carve-out from fiduciary status for providing investment education to IRA owners,** and not just to plan sponsors and plan participants as under the 2010 proposal. It also updates the definition of education to include retirement planning and lifetime income information. In addition, the proposal strengthens consumer protections by classifying materials that reference specific products that the consumer should consider buying as advice.
- **Determines who is a fiduciary based not on title, but rather the advice rendered.** The 2010 rule proposed that anyone who was already a fiduciary under ERISA for other reasons or who was an investment adviser under Federal securities laws would be an investment advice fiduciary.
  Consistent with the functional test for determining fiduciary status under ERISA, the proposal looks not at the title but rather whether the person is providing retirement investment advice.
- **Limits the seller's carve-out to sales pitches to large plan fiduciaries with financial expertise.** This responds to comments that differentiating investment advice from sales pitches in the context of investment products is very difficult and, unless the advice recipient is a financial expert, the carve-out would create a loophole that would fail to protect investors.
- **Excludes valuations or appraisals of the stock held by employee-stock ownership plans (ESOPs) from the definition of fiduciary investment advice.** The proposed rule clarifies that such appraisals do not constitute retirement investment advice subject to a fiduciary standard. DOL may put forth a separate regulatory proposal to clarify the applicable law for ESOP appraisals.

Prepared Statement of Financial Engines

RESTRICTING ADVICE AND EDUCATION: DOL'S UNWORKABLE INVESTMENT PROPOSAL FOR AMERICAN FAMILIES AND RETIREES

Thank you for the opportunity to submit this statement for the record. We appreciate the committee's and subcommittee's interest in the important topic of investment advice and education.

The American retirement landscape has changed dramatically. Updating the current retirement plan rules crafted 40 years ago is critical to improving protections for retirement investors. In this regard, Financial Engines supports the Department of Labor's ("DOL") proposal to update the definition of fiduciary ("fiduciary proposal"). Since it launched its first service in 1998, Financial Engines has provided high quality services in a fiduciary capacity to large numbers of plans and participants; we are proud to serve as an example that it can be done. We believe that the proposed rule is workable—for providers of advice services, and beneficial—for recipients of those services.

FINANCIAL ENGINES

Financial Engines was founded to accomplish the vision of its co-founder and Nobel Prize winner Bill Sharpe: To provide high-quality independent investment advice to everyone, regardless of their wealth or investment experience. Today, Financial Engines provides personalized investment advice to 9.6 million employees of large employers, including 146 companies of the Fortune 500. Financial Engines is not affiliated with any other financial services entity, does not manufacture or sell products, and does not accept commissions.

Financial Engines assists individuals with developing a personalized and comprehensive savings, investing, and retirement income plan. For example, Financial Engines provides advice to individuals near retirement on the advantages of delaying social security in order to maximize monthly benefits. Financial Engines uses sophisticated technology to deliver services that help individuals set a risk level appropriate for when they plan to retire, and to design a diversified investment portfolio from among the investment choices available in their employer's 401(k) plan to help them reach their retirement income goals. Financial Engines can also manage the employee's, or their spouse's, IRA assets, affording holistic management of all sources of retirement income.

Financial Engines can either professionally manage an employee's account or provide online advice through expert recommendations and interactive tools. Financial Engines provides a retirement-readiness assessment, including estimated annual retirement income from Social Security, their 401(k), IRAs, and pension, if applicable, to all employees in the plans we serve. With the Income+ feature of Financial Engines' Professional Management service, Financial Engines will manage the portfolio to be ready to generate retirement income, and can generate steady payouts that are designed to last for life (with the purchase of an optional out-of plan fixed annuity). Members are not locked in, can vary the amount of payouts to suit changing circumstances, and can cancel at no charge at any time.

CRITICAL NEED FOR RETIREMENT INVESTMENT ADVICE

The American retirement landscape has changed dramatically since the current retirement plan rules were crafted 40 years ago. Professionally managed pension plans have given way to individually managed 401(k) and Individual Retirement Accounts ("IRAs"). Individual investors with these accounts need help, and with more than 88 million individual investors now largely responsible for managing their own retirement assets, there has never been greater demand for high-quality investment advice.

The need for new rules is clear since potential conflicts of interest do exist in the retirement business. Financial "advisors" too often steer investors toward products that offer higher fees and commissions for the "advisor," not what will provide the best retirement outcome for the investor. Complex fee-sharing arrangements, commission structures, and other conflicts of interest create pressures—sometimes overt, sometimes subtle—to shade recommendations in the interests of the "advisor." Often investors are unaware that these conflicts of interest even exist. Workers end up with investments that have lower returns and higher fees, siphoning off tens of thousands of dollars in savings from the average person's retirement account. Advisors may also have incentives to move investors from low-cost 401(k) plans to more expensive retail IRAs.

The potential harm to consumers from these conflicts of interest is significant. A 2013 study published in the Journal of Finance entitled "What do Consumers' Fund Flows Maximize?" showed that even brokers who are unaffiliated with a mutual fund company—whom you might expect to be unbiased—steer their clients toward mutual funds that pay the brokers more, but that underperform by over 1 percent annually on average. While 1 percent might not sound like much, this annual underperformance can translate into a retirement balance that is tens of thousands of dollars lower over a 30-year career.

DOL FIDUCIARY PROPOSAL

Given the changes in the retirement arena, Financial Engines supports the DOL's fiduciary proposal. Current regulation may not adequately protect the interests of retirement investors and may limit unnecessarily the scope of ERISA's fiduciary protections. ERISA's fiduciary standards provide important protections against conflicts of interest and self-dealing and, particularly in light of changes in the financial industry, it is crucial now more than ever to re-examine the types of relationships that should give rise to fiduciary duties under ERISA and to apply these protections broadly.

Moreover, our experience has demonstrated that financial advisors can provide independent, conflict-free investment advice, putting the interests of customers first, even when investors have smaller balances and still produce solid business results. Technology has allowed for the provision of high-quality, objective, and personalized investment advice at a much lower cost and much broader scale than was possible 40 years ago. Financial Engines is now the Nation's largest independent registered investment advisor, a public company, and an industry leader managing over $100 billion in retirement assets, providing personalized investment advice to millions of 401(k) investors. It is important to note that half of the 9.6 million participants with access to Financial Engines' services have less than $32,000 in retirement savings. Some have as little as a few hundred dollars in their accounts. We are proud to serve as an example that it can be done.

CONCLUSION

We appreciate the opportunity to submit this statement for the record. We look forward to working with the committee and subcommittee as they consider the important issues of retirement security.

[Huffington Post, July 20, 2015]

Senate Republicans Think Herbalife Is A Good Model For Your Retirement Savings

(By Zach Carter, Senior Political Economy Reporter)

GOP HEARING SHOWCASES PRESIDENT OF PRIMERICA, A MULTI-LEVEL MARKETING COMPANY

WASHINGTON—In 2010, Citigroup decided to sell what was widely regarded as one of its dodgiest operations. The struggling Wall Street titan was trying to streamline its management structure and upgrade its reputation after a massive government bailout, and one line of business its executives could live without was Primerica.

Primerica, now an independent company, is a financial services operation modeled on multi-level marketing enterprises like Amway, Nu Skin and Herbalife. Unlike traditional retirement and insurance firms that employ a relatively small number of highly paid financial professionals, Primerica had more than 98,000 people enlisted in its sales force last year, recruited through feel-good videos and pitches to the family and friends of existing salespeople.

If you're willing to work hard enough, Primerica tells prospective "entrepreneurs," you can run your own successful business selling insurance or retirement packages. Primerica agents get paid a commission on each sale, and—just like Amway and Herbalife—also earn commissions for sales their recruits make. A commission on their recruits' recruits, and their recruits' recruits recruits. And so on.

Like other multi-level marketing operations, Primerica holds huge splashy motivational conferences for its sales team, where executives fete top earners amid fireworks and flowers. As with Herbalife, Nu Skin and similar platforms, the pitch to prospective Primericans is a vague, highly emotional appeal that suggests not only financial rewards, but the revitalization of a lifestyle. In one promotional video, Rob Cooper of Fort Worth, TX, encourages his audience not to settle for "a mediocre life like everybody else does."

"One of the greatest thing[s] Primerica has to offer is they encourage goals, they encourage dreams," Cooper says. "And you really know—man, if you're willing to go out there and work hard, then you can actually achieve everything you ever wanted to achieve."

"The same life. The same boring routine," says Houston's David Farmer in another video. "I didn't want that life . . . I saw Primerica as my way to take back control of my life."

"I always wanted to be somebody," says Jeff Fieldstad of Las Vegas in another. "I always wanted to do something great."

Of course, for most people, it doesn't quite work out that way. More than 190,000 new recruits paid a fee to sign up for Primerica in 2014, according to the company's annual report with the Securities and Exchange Commission. Primerica only boosted its total licensed sales force by 3,700 that year, and each member of the sales team earned an average of $6,030.

Senate Republicans are apparently sold. The GOP has called on Primerica President Peter Schneider to testify against a new Obama administration retirement security proposal at a Tuesday hearing before the Senate Committee on Health, Education, Labor, and Pensions.

The Department of Labor rule would impose a "fiduciary duty" on investment advisers, requiring them to act in the best interests of their clients. It would bar account managers from steering people into financial products that maximize benefits for investment specialists, rather than retirees. The Obama administration calculates that Americans lose $17 billion a year to hidden fees and conflicted investment advice.

In other words, the rule is designed to prevent exactly what 238 Florida workers said Primerica did to them in the years leading up to the financial crisis—steer them into inappropriate financial products for the personal financial gain of the sales team.

In 2012, lawsuits began pouring in, alleging that Primerica reps had convinced Florida firefighters, teachers and other public workers to invest in inappropriate retirement products. Even though the workers were near retirement, Primerica representatives encouraged them to ditch their government pension plans for much riskier government 401k accounts, which do not guarantee a minimum monthly payout in retirement. Dumping a pension plan for a 401k on the verge of retirement is frowned upon in the investment advice world. It needlessly jeopardizes retirement security, while offering little potential benefit.

The scheme posed major potential profits for Primerica's sales reps. Once these workers retired and moved out of their government plans, Primerica agents stood to profit from managing their retirement assets. Had they stayed in the pension programs, retirees would have simply collected their monthly payments, leaving nothing for Primerica to manage, and no commissions for Primerica agents to harvest. In January 2014, Primerica set aside $15.4 milliom to settle allegations involving 238 such cases.

Primerica told *HuffPost* that Florida State regulators did not object to its agents' actions. The company also said that the retirees it settled with never actually signed up for Primerica products after taking the company's investment advice. Indeed, the workers were so steamed by the lousy advice that they did not ultimately ask Primerica to manage their now-diminished assets in retirement.

It's not terribly shocking that a financial company run like Amway would run into trouble. It is perhaps surprising that Senate Republicans seem to think Primerica makes for a sympathetic ally in their public campaign against a financial reform proposed by President Barack Obama.

"The unintended consequences of the DOL's proposed rule will be to make it more difficult for these households to receive desperately needed retirement guidance," Primerica told *HuffPost* in a written statement.

The GOP's disdain for the fiduciary duty rule is clear from the hearing's title: "Restricting Advice and Education: DOL's Unworkable Investment Proposal for American Families and Retirees." Unworkable, apparently, because Americans might miss out on the opportunity to receive investment advice from someone looking to cash in on a get-rich quick operation.

[The Wall Street Journal, May 4, 2015]

Creative Destruction at a Broker Near You

(By Burton G. Malkiel and Adam Nash)*

TECHNOLOGY IS CHANGING THE GAME FOR SMALL INVESTORS. HERE'S HOPING THAT REGULATION DOESN'T DERAIL PROGRESS

Technology is fundamentally altering the investment landscape, and it may have a profound influence on the quality of service that individual investors receive. This change also is relevant for evaluating the controversy currently roiling the securities industry.

After 4 years of study, the Labor Department announced in April a proposed amendment to the definition of "fiduciary" under the Employee Retirement Income Security Act. The rule would impose a strict fiduciary standard on those providing retirement advice to individual retirement account (IRA) holders, and also clarify and add to existing standards for advisers to 401(k) and other retirement plans.

In short: Anyone who receives compensation for providing retirement advice must put their clients' "best interest" first, as opposed to recommending products that are deemed to be broadly "suitable" but that compensate advisers more than competing

*Mr. Malkiel is the chief investment officer and Mr. Nash is chief executive officer of Wealthfront, an automated investment service.

low-fee investment funds. While it might seem obvious that investors deserve advice that puts their interests first, the proposal has engendered a storm of protest.

The guiding principle of the Labor Department's proposal is absolutely correct and long overdue. All too often investors in retirement plans pay higher fees than they should, and their accounts contain high-cost funds that reward the provider of advice rather than the client.

Still, the devil is in the details—and the Labor Department's 400-plus page proposal requires careful scrutiny. The government must be careful not to prevent institutions from giving investment advice as long as all conflicts and fees are revealed to clients. It also is important to consider if there are unintended consequences that could leave some investors less well off.

The U.S. Chamber of Commerce and Sifma (the Securities Industry and Financial Markets Association), along with others, see significant problems with the Labor Department's proposal. They argue that the new fiduciary standard will force investors to move from commission-based accounts to costlier, fee-based advisory accounts. The result, they believe, is that investor choice and access to financial education regarding retirement accounts will be limited—and that small investors will be badly harmed.

Currently a broker may recommend a high-expense mutual fund for a client investing in a 401(k) rollover or a new IRA. The broker is compensated by receiving a commission for selling the fund, and is only required to ensure that the fund is a "suitable" investment. Many fee-based advisers require minimum investments in the six figures, and they charge fees that would be prohibitively expensive for small and medium-size investors. Large brokerage and insurance firms argue that only a commission-based model can work for the average investor.

Missing in this controversy is how technology will upend the current brokerage model. The only question is whether technology also will be the bridge that allows the industry to adapt to new fiduciary rules and provide individual investors low-cost advice that does not pit the interests of advisers against clients.

Over the past few years a number of software-based, automated investment advisers have been established, and they are growing rapidly. Firms such as Future Advisor, Rebalance IRA, and our own firm, Wealthfront, now provide low-cost, high-quality alternatives to antiquated investment models. Even large traditional incumbent firms, like *Charles Schwab and Vanguard*, are investing heavily in technology to provide high-quality, fiduciary service to small investors.

These automated investment services are able to provide sophisticated portfolio management to small investors at incredibly low cost by leveraging the same type of technology that has helped companies like *Facebook* and *Google* scale to billions of users. Some automated advisers will even manage accounts of less than $10,000 without charging any advisory fee. Accounts over $10,000 might pay a management fee of only 25 basis points (one-quarter of 1 percent), a fraction of the typical 1 percent that traditional investment managers charge.

Investments are made in portfolios of low-cost, exchange-traded index funds tailored to the needs and risk tolerance of the client. No trading commissions are charged, and conflicts of interest can be avoided. If we are in an era of future low-gross investment returns, as many investment managers believe, rock-bottom fees are especially important.

The services offered by the new computer-based advisers are not second rate. Client accounts can receive daily monitoring and management rather than the quarterly or annual reviews provided by many traditional advisers. Accounts can be automatically rebalanced and moved to somewhat safer asset-class allocations as the investor's financial situation evolves. Every trade is automatically vetted against the investment strategy promised to the client.

The securities industry is correct to worry that a strict fiduciary standard is likely to result in massive changes in traditional ways of doing business. Business models that depend on selling high-cost, low-value proprietary products to clients will be threatened, with the result that there may be fewer broker-dealers and investment advisers to choose from.

The best firms will invest heavily in the technology to better address the needs of small investors. Investors will pay less, not more, for the services they receive, and what they get will be better, not worse. Capitalism has always involved a painful process of creative destruction. The financial-services industry will be stronger and more effective because of innovation, and the fiduciary standard will accelerate the process of changing outmoded and ineffective financial business models.

SAVE OUR RETIREMENT,
JULY 20, 2015.

Hon. LAMAR ALEXANDER, *Chairman,*
Committee on Health, Education, Labor, and Pensions,
U.S. Senate,
Washington, DC. 20510.

HON. PATTY MURRAY, *Ranking Member,*
Committee on Health, Education, Labor, and Pensions,
U.S. Senate,
Washington, DC. 20510.

DEAR CHAIRMAN ALEXANDER AND RANKING MEMBER MURRAY: As organizations that want to see protections for retirement savers strengthened, we write to express support for the Department of Labor's proposed rule—now out for public comment—that would close loopholes and update the standards for retirement investment advice under the Employee Retirement Income Security Act (ERISA).

Americans who save and invest for a secure and independent retirement should be able to trust that the retirement investment advice they receive is in their best interest. Workers and retirees are more dependent than ever on financial professionals to help them navigate the complex decisions they must make to fund a secure and independent retirement. Unfortunately, because of loopholes in rules specifying who is a "fiduciary" under ERISA, many of the financial professionals whom retirement savers rely on for advice are legally allowed to put their own financial interests ahead of the interests of their customers. While many of these professionals nonetheless seek to do what is best for their customers, others take advantage of gaps in the regulations to steer their clients into high-cost, substandard investments that pay the adviser well but eat away at retirement savers' nest eggs over time. This is a particular problem for small savers who are disproportionately served by nonfiduciary advisers and receive conflicted advice.

After years of thoughtful analysis and consultation with all stakeholders, the Department of Labor has drafted a comprehensive proposal that closes loopholes in the definition of investment advice so that anyone who provides individualized investment recommendations to retirement savers—whether they are saving through a traditional or defined contribution pension plan, such as a 401(k), or an Individual Retirement Account (IRA)—would be required to provide best interest advice to their clients. Importantly, the proposed rule would eliminate outdated requirements that advice must be "regular" or serve as the "primary basis" for an investor's decision, before the best interest standard applies. In a significant improvement over the 2010 proposal, it covers advice about recommendations to roll money out of a pension or 401(k) plan and into an IRA. This is the most important financial decision many people will ever make, with a potential to seriously affect their standard of living in retirement, and is a special area of concern given extremely troubling practices identified in a GAO report.

By updating these standards and closing these loopholes, retirement savers will undoubtedly experience better investment outcomes. At the same time, the proposed rule would provide sufficient flexibility for financial professionals and their firms so they can continue to charge commissions and other sales-based compensation. This reflects a balanced approach that preserves the broker-dealer business model while ensuring that retirement investors of all incomes and portfolio sizes will receive advice that is in their best interest.

We encourage you to stand with your constituents—who are saving for retirement and deserve to have the best financial advice for their future—and support the Department of Labor's rulemaking process as it moves forward.

Sincerely,

AARP; AFL–CIO; Alliance for Retired Americans; American Association for Justice; American Association of University Women (AAUW); American Federation of Government Employees (AFGE); American Federation of State, County and Municipal Employees (AFSCME); Americans for Financial Reform; Better Markets; Center for Community Change Action; Center for Economic Justice; Center for Global Policy Solutions; Center for Responsible Lending; Certified Financial Planner Board of Standards; Consumer Action; Consumer Federation of America; Consumers Union; Financial Planning Association; Fund Democracy; Garrett Planning Network, Inc.; International Association of Machinists and Aerospace Workers; International Union, United Automobile, Aerospace & Agricultural Implement; Workers of America (UAW); Justice in Aging; Leadership Conference on Civil and Human Rights; Main Street Alliance; National Active and Retired Federal Employees Association (NARFE; National Association of Social Workers; National Committee to Preserve

Social Security and Medicare; National Consumers League; National Council of La Raza; National Employment Law Project; National Women's Law Center; Pension Rights Center; Personal Capital; Public Citizen; Public Investors Arbitration Bar Association; Rebalance IRA; The Committee for the Fiduciary Standard; U.S. PIRG; Wider Opportunities for Women.

RESPONSE BY SCOTT PURITZ TO QUESTIONS OF SENATOR ISAKSON AND SENATOR FRANKEN

SENATOR ISAKSON

Your testimony says:

> "Our clients come from all walks of life including nurses, school teachers, plumbers, lawyers, welders, professors, police, doctors, farmers, government employees—i.e., regular Americans."

Question. As noted, these regular Americans must have at least $100,000 in savings in order to be a customer. Also, Rebalance IRA says that it has approximately $275 million in assets on behalf of more than 500 clients. That is an average account size of $550,000, not exactly average Americans. Your client base appears to be significantly more financially sound, than those who DOL's proposal purports to protect.

Why would you so outspokenly support a proposal which your clients have such an ability to absorb if they were to lose access to advice or education?

Answer. Rebalance IRA is part of a broad trend of new investment advisory firms that seek to provide consumers with a fundamentally better set of retirement investment options, offering retirement investment advice to clients at all income levels for very modest fees. Several of these advisory firms have account minimums as low as $500. Generally, those requiring the lowest minimums rely on software to lead the advisory process, with human input as a secondary feature as needed.

At Rebalance IRA, our clients seek the added assurance of human-led advice enhanced by technology because they feel they need advice about how to holistically manage their retirement planning and how to understand the increasingly complex world of investment products. Our clients do come from all walks of life, including nurses, school teachers, plumbers, lawyers, welders, professors, police, doctors, farmers, and government employees—i.e., regular Americans. Averages, as you know, can be misleading. Our target client has considerably less than the figure cited. In fact, 43 percent of the Rebalance IRA-client base has retirement account balances in the range of between $100,000 and $250,000.

SENATOR FRANKEN

Question. How would you respond to claims that: the new technologies that have produced low-cost, computer-generated retirement investment models have only operated during the bull market of recent years, and their ability to manage funds, or respond to investor concerns when the market changes has yet to be tested?

Answer. Rebalance IRA is part of a broad trend of new investment advisory firms that seek to provide consumers with a fundamentally better set of retirement investment options, offering retirement investment advice to clients at all income levels for very modest fees.

Rebalance IRA and many of the other "investment innovators" harness an investment methodology known as modern portfolio theory (MPT). Developed through finance research dating back decades and across multiple bear markets of the past, MPT seeks to increase investment return while lowering risk. The heart and soul of the concept is diversification. The idea is to own a variety of asset classes, thus avoiding the concentration of risk into any given single investment.

MPT has been the gold standard for prudent institutional investment for decades. Finance research experts, major endowments, pension funds, and private investment professionals broadly agree that MPT is a safe, solid, repeatable method for managing an investment portfolio in both bull and bear markets.

Diversification is more than simply putting your eggs into different baskets. It actively lowers risk. That is because asset classes generally are "uncorrelated," that is, as one declines in value, another rises. The stabilizing effect of diversification is amplified by adding up to six asset classes to an investment portfolio. A thoughtful collection of asset classes thus offers a lower investment risk than any single asset. Interestingly, research shows that adding asset classes that some might perceive as "risky" in fact lowers the overall risk in a portfolio. For this reason, diversification rightly has been described as "the only free lunch in the investment game."

Using MPT, investments are statistically measured in terms of both their expected long-term rate of return and their short-term volatility. A portfolio is then created that combines assets in such a way that the return is the weighted average of the assets held within.

In a given year, different asset classes perform differently, making it difficult to predict which asset will perform best. By combining assets whose returns are uncorrelated, MPT seeks to reduce the total variance of the portfolio. A reliable return with lower risk and lower cost, compounding over time, creates a winning retirement portfolio.

In practice, MPT is the opposite of "stock picking." Analysts who pick stocks attempt to find a small group of stocks or bonds that they believe will outperform entire markets represented by a corresponding index, such as the S&P 500. Instead of analyzing and purchasing single companies or sectors, however, MPT counsels investors to buy the index itself.

Dr. Charles D. Ellis is a highly respected investment expert, a former chairman of the Yale Endowment, a former board member of Vanguard Group and today a member of the Rebalance IRA Investment Committee. In August 2014, Dr. Ellis published a landmark article in the well-respected *Financial Analysts Journal* entitled "The Rise and Fall of Performance Investment" in which he documents the fact that the majority of active investment managers now underperform the market. This powerful conclusion is corroborated by decades of academic research. He makes the case for a viable alternative to active management—MPT implemented using low-cost index funds.

Historically, however, MPT-based advice has been available only through high-end financial advisors who typically require minimum account sizes of $1 million and who charge annual fees of at least 1 percent of assets under management. Rebalance IRA, and other investment innovators seek to democratize modern portfolio theory by bringing this level of investment advice to everyone for a fraction of the cost.

[Whereupon, at 4:17 p.m., the hearing was adjourned.]

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