

The Securities Industry And Financial Markets Association

Statement For The Record

Public Hearing On Proposed Investment Advice Regulations

And

Proposed Investment Advice Class Exemption

Presented By

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Good morning. My name is Bill Ryan, and on behalf of SIFMA, I appreciate the opportunity to testify before you today. We appreciate the Department's investment advice initiatives and support the Department's decision to hold a hearing on this very important proposal.

We strongly support the proposed regulation and class exemption and commend the Department of Labor for their work. The regulation and exemption have been subject to a thorough process of evaluation and analysis and we believe that with a few modifications, will serve retirement plan participants and IRA investors for many years to come. We believe that the Department faithfully and closely interpreted the statutory requirements in the proposed regulation. At the same time, it must be recognized that the statutory exemption and the regulations promulgated under that regulation, have intrinsic

limits that make it less helpful to many plan participants and IRA owners. The class exemption is a necessary step that will lead to better decision-making and enhance retirement security for millions of individuals. Without it, millions of Americans will get no advice at all.

In the late 1970's, 62 percent of the full time workforce was covered by a defined benefit plan. Very few workers had access to a defined contribution plan. Today, about 63 percent of the full time workforce is now covered by a 401(k) plan. These plans hold more than \$2 trillion in assets; over time, as employees switch jobs, they will often distributions from their 401(k) plan and roll them into individual retirement accounts ("IRAs"). IRAs now account for the bulk of retirement savings, with \$4.75 trillion held at the end of 2007. In addition to rollover activity, another factor contributing to the growth of IRAs is a change in how benefits in defined benefit plans are paid. In 1975, virtually all defined benefit plans paid benefits in a life annuity. Today, a high percentage of defined benefit plans provide the option of a lump sum payment, which will also be rolled into IRAs. Thus, unless the regulations and class exemption can successfully permit the delivery of advice to the vast majority of American workers, the future of retirement security will indeed be in jeopardy.

To the extent that 401(k) and IRA accounts are not wisely invested, American retirees' ability to support themselves in their retirement is seriously threatened. According to a survey recently released by CIGNA Retirement and Investment Services, 89 percent of 401(k) investors want "specific information on investment decision-making." These same investors, if asked about their IRAs, would answer that question the same way. There are more than 50 million American workers who are retired or in

striking distance of retirement. The financial services industry has an army of financial professionals, well positioned to provide investment advice. Without this delivery system, cost-effective professional advice will not be available. The proposed regulations and class exemption are devised to harness this professional expertise. The combination of full disclosure, acceptance of fiduciary liability, and independent review, are significant protections that will protect plan participants and IRA owners.

The last few months are a graphic illustration of the pressing need for participants in 401(k) plans and IRAs to receive meaningful, prompt and individualized investment advice. Retirees and workers are terrified about market uncertainties; their retirement savings are at risk, and they are flailing for guidance and specific answers. There is simply no effective way to deliver that kind of advice to the majority of American workers other than through registered advisors, brokers, insurance agents and other established delivery systems. The current system is only working for those who can afford a fee-based advisor or those with the confidence to rely on do it yourself investing with a computer-generated asset allocation. We strongly believe that the best, most stabilizing advice, is one on one, person to person, especially in times of financial turmoil.

We understand that there are some who claim that if advice is given by advisors with ties to the products they sell, the advice will never be in the interest of participants and beneficiaries. We strongly believe those views are mistaken and misunderstand product delivery systems. Since current law restrictions have crippled any broadly provided investment advice initiatives, we agree with the Department that the practical reality is advice in the form proposed is in the interest of participants and beneficiaries as

opposed to the current status of hardly any advice at all. As a nation, we simply cannot afford to address the unfulfilled demand in this area.

Proposed Regulation

We think the proposed regulation adheres closely and faithfully to the statutory exemption. SIFMA's written comment letter, dated October 6, describes areas where additional improvements should be made. Critics of the proposed regulation suggest that the regulations go beyond the scope of the statute by requiring only the advisor and the employee/agent to have level fees and not extending this fee leveling requirement to all affiliates. Not true. Nowhere in the statute or legislative history, did Congress mandate that all affiliated companies be level as well. Indeed, such a provision would have made no sense, because if there are no fee differences at all, there would be no prohibited transaction at all, and thus, no need for exemptive relief.

The Department has issued several class exemptions that do not require fee leveling at any level. If Congress did not believe these prior exemptions were protective of plans and participants, Congress had ample opportunity to provide oversight and make that clear. In addition, the Department first issued its interpretation of the PPA's statutory fee-leveling requirement in February of 2007. SIFMA is not aware of any letters objecting to the fee-leveling guidance. It is likely that there are at least a handful of advice providers relying on this guidance today.

Finally, critics of the proposed regulation also suggest that in the disclosure provided to participants and IRA owners, the "profitability" of each option should be

described. While we strongly support disclosure tools, this is one disclosure element that would be unworkable, would require the disclosure of proprietary information, and is a major departure from any other exemption, regulation or guidance ever issued by the Department. How would the profitability of a commission payment be determined?

There is no way to attribute a profit or loss to an investor, advisor, an account or a particular transaction. Internal profit calculations relate to efficient deployment of personnel and resources. This data has nothing to do with the participant's investment decision. The relevant data point for a participant is the fee differential, i.e., advisor receives 20 basis points versus 25 basis points.

Proposed Class Exemption

In our view, the proposed class exemption carefully balances the need to broadly disseminate investment advice in a practical way to millions of participants in a manner that will be useful to them, while at the same time imposing controls that will be protective of participants and IRA owners and make conflicts transparent to these individuals so that they can assess the advice dispassionately. This was no easy task and we think the Department struck the right balance.

Critics of the proposed exemption suggest that the Department does not have the authority to issue a class exemption that varies from the statutory exemption. Not true: both under the terms of the PPA and ERISA since its adoption in 1974: First, under the PPA, Congress mandated that the Department issue an exemption for IRAs if it found that models were not feasible for IRAs. By definition, the mandated exemption would

differ from the statutory exemption. In addition, under ERISA section 408(a), the Department has full authority to issue a class or individual exemption whenever it determines that it is administrable, in the interests of participants and beneficiaries and protective of their interests. Nowhere in that grant of authority did Congress suggest, either in the statute or in the 1974 ERISA Conference Report, that the Department could not grant an exemption unless the exemption provided the same terms and conditions of similar statutory exemptions. The 1974 ERISA Conference Report, in particular stated that “[t]he conferees recognize that some transactions which are prohibited (and for which there are no statutory exemptions) nevertheless should be allowed in order not to disrupt the established business practices of financial institutions . . . [and] the conferees expect that the Secretary of Labor and the Secretary of Treasury would grant a variance with respect to these services (and other services traditionally rendered by such institutions), provided that they can show that such variance would be administratively feasible and that the type of transaction for which an exemption is sought is in the interest of and protective of the rights of plan participants and beneficiaries.” In line with this Congressional directive, the Department grants exemptions, both individual and class, which take account of different aspects of the market which may not have been apparent to Congress when statutory exemptions were considered, including foreign securities, securities lending, investment in mutual funds, securities underwritings and many many more. Nothing in the PPA in particular, or ERISA in general, would limit the Department’s authority to grant the exemption proposed here, so long as the Department makes the findings required by section 408(c).

Nor do we think the critics are correct that the Department cannot make the findings required by the statute. Ensuring that an advisor's fees and other compensation are not tied to the investment advice will require the concerted effort of the Department of Labor, internal compliance reviews, and independent audits. We are quite sure it can be done and can be audited. It is not easy or inexpensive to provide disclosure on the material conflicts and fees that an advisor's affiliates will receive but we are quite sure that it can be done and can be audited. It may not be simple to test a model for slant or bias, but we are quite sure that an expert can do it. The proposed class exemption has many conditions that will protect participants, and while we do not agree with all of them, we believe that in total, they support the Department's findings in proposing the class exemption.

How does the class exemption protect participants and IRA account holders?

First, these rules identify who is eligible to give advice. Those eligible are firms and individuals that are already subject to another form of regulation – through the securities laws, insurance regulation, or banking.

Second, the rules provide for significant disclosure and recordkeeping. The disclosure obligations under the exemption are far-reaching. If there is a proprietary interest in the option, there will be disclosure. If the advisor or affiliate receives fees – indirect or direct – there will be disclosure. If there is a non-monetary relationship between the advisor and the option, there will be disclosure. In the case of IRAs, the fact that the account holder can separately arrange for advice from another adviser that is “independent” will be disclosed. If the advisor recommends a product with a higher fee, there will be specific disclosure and disclosure of the basis for the recommendation.

Third, the advisor will affirmatively accept fiduciary status. Only those firms and advisors who are willing to accept the obligation will utilize the exemption. Of course, fiduciary status requires acting in the best interest of the participant or account holder.

Fourth, the class exemption requires that the advice be non-discretionary. In otherwords, the participant must take the initiative to implement the advice.

Fifth, the class exemption requires an evaluation through an independent audit that the advice was objective and the disclosure is adequate. The audit requirement will mean, in effect, that there will be two levels of oversight. First, firms that offer investment advice based on the exemption will have internal control procedures that must be complied with. There will be internal review to ensure compliance. Then, the firm must permit an independent auditor to review the advice provided and their internal controls. This is a very significant requirement and will likely increase the expense of providing advice. We believe that critics of the exemption have dismissed this requirement hastily; while accepting, on its face, that computer models are inherently objective.

Sixth, the class exemption does provide for a fee-leveling alternative. This can be an important safeguard as well. Eliminating this potential adviser bias can be very helpful and is used in many firms today. However, the class exemption recognizes that a level fee requirement may not be workable in the context of many IRA account holders. As SIFMA testified previously, the IRA account holder who is near retirement age may be looking at multiple types of investments and it would be impossible for a diversified financial services firm to “levelize fees” for these advisors without totally changing the business structure.. Some may respond that this is to be desired – all advisers must be

entirely fee-based. Unfortunately, that will mean that millions of workers will be left without any individual advice. We searched the database of the National Association of Personal Financial Advisors (an entirely fee-based association) to locate an advisor in Iowa. Thirteen advisors were listed in the entire state. We suspect that even the hardest working advisors could not begin to meet the demand for guidance from the millions of workers who are reaching retirement age and who do not have significant savings to pay for a fee only advisor. .

Finally, we ought not forget the very significant costs that will be imposed on the fiduciary advisor, and the affiliated group, if there is a failure to follow these requirements. A prohibited transaction results in the reversal of the transaction. The plan or IRA is required to be made whole for any losses, pay a substantial excise tax, and subject to civil liability under ERISA section 502. These significant costs and potential liabilities for noncompliance are powerful incentives for any financial services firm to make sure that its advisors comply with all the conditions of the exemption.

In commenting on the fee leveling requirements of the statutory exemption, if imposed on both an adviser and his or her employer, large financial institutions would have to totally reorganize their businesses in order to achieve entity-level compensation. In so doing, individual advisors would have to choose whether to be employed by the new, all level compensation entity, or to remain with the broker dealer, insurance company, or bank. Even putting aside the expense and delay of entirely reorganizing a corporate structure, we, and others raised concerns that the “best and brightest” would refuse to change employers within the affiliated group. We think the Department made the right judgment in deciding that the adverse effects of making the entity level

outweighed the protection to participants. We believe it is critical to keep in mind that under current law, there is very little investment advice being given to anyone. The less realistic the exemptive relief, the more likely we have the same status quo in the future.

The same is true of off-model advice. Under the Department's Sun America advisory opinion, if a third party constructs the model and only advice from the model can be implemented, no exemptive relief is required. Our members' experience is that participants are uncomfortable with the output of the model, and exasperated at the need to keep changing the inputs and rerunning the model, rather than asking their financial adviser what to do before they can effectuate their choices. What is important is what the model initially says, coupled with disclosure on the conflicts and fee increases for the advisor if other choices are made, with the additional protection of an independent audit.

We do not think the Department should give credibility to claims that advisors will solicit participants by pointing out weaknesses in the models. In many cases, the models will be developed by the firms providing the advice, certified by a third party. This is not an inexpensive undertaking and access to good technology is very important to financial advisors. They would not be doing their reputation or their firm's reputation any good if they demeaned the model that their own firm developed.

In sum, we believe that the Department has carefully crafted a set of rules that will result in a far more widespread delivery of advice to participants while protecting them against conflicts and self-dealing. It relies heavily on very clear disclosure and is grounded in the prudence rules of ERISA section 404. We urge the Department to finalize the rules promptly.

We thank you for permitting SIFMA to testify today.