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Securities Industry and
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Testimony of

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Good morning. My name is Marc Lackritz and I am President and Chief Executive Officer of the Securities Industry and Financial Markets Association ("SIFMA").[1] Our diverse member firms provide a vast array of financial products and services to investors from all walks of life, including custodial, brokerage, and advice services to more than 13 million IRA accounts.

We appreciate the opportunity to testify on an issue of great importance to millions of IRA account holders: the feasibility of requiring a computer model as the medium for

[1] The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers locally and globally through offices in New York, Washington D.C., and London. Its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong. SIFMA's mission is to champion policies and practices that benefit investors and issuers, expand and perfect global capital markets, and foster the development of new products and services. Fundamental to achieving this mission is earning, inspiring and upholding the public's trust in the industry and the markets. (More information about SIFMA is available at http://www.sifma.org.)

providing investment advice. We do not believe a computer model that meets the statutory requirements of the *Pension Protection Act of 2006* (PPA) is either effective or feasible. We urge the Department to make such a finding, and to issue a disclosure-based exemption for the provision of investment advice for IRAs.

<u>Overview</u>

Investors deserve clear, understandable, relevant, customized investment advice so that they can make decisions tailored to their own circumstances. Individuals should have robust choices when making financial decisions, and should not be forced into a one-size-fits-all approach of a computer model that simply cannot offer the level of service an investment advisor can. Indeed, investment advice encompasses much more than any existing computer model provides. In a key survey of mutual fund investors, nearly two-thirds of shareholders identified asset allocation as only one of five distinct services they received from their advisers. They also identified financial planning assistance, retirement asset management, and investment recommendations as services that were regularly provided in these advisory relationships.[2]

Importantly, investors who have used a professional financial advisor say they have done everything they can to financially prepare, and they feel more comfortable with their knowledge and involvement in saving for retirement than those who have not.[3] A recent Forrester survey concluded that for every generation, independent financial advisors and financial advisors at brokerages "are at the top of the list of most helpful resources for

[2] Investment Company Institute, "Why Do Mutual Fund Investors Use Professional Financial Advisers?," Fundamentals, Vol. 14, No. 3, April 2007, pgs. 2–3.
[3] Artemis Strategy Group survey, *Retirement: Americans are Tuning In*, conducted on behalf of SIFMA, June 12, 2007, pg. 4.

retirement research."[4] Consumers who have used the Internet to research retirement put the channel right behind human advisors in terms of helpfulness, but online solutions or other Web-based guidance programs simply aren't good enough yet to attract more than a fraction of the population. Moreover, those who are most likely to use the Internet to plan for retirement are the least confident in their ability to estimate when they'll retire, how much it will cost, and where the money will come from.[5]

Growing Importance of Investment Advice

The retirement landscape is undergoing dramatic changes. When ERISA was enacted in 1974, many workers counted on the combination of an employer-sponsored defined benefit plan, Social Security, and personal savings to ensure their financial security in retirement. At that time, 62 percent of the full-time workforce was covered by a defined benefit plan.[6] The burden of paying the promised benefit rested solely on the federal government and employers. Very few of those workers had access to a defined contribution plan. Today, that number is reversed. About 63 percent of the full-time workforce is now covered by some type of defined contribution plan.

As defined contributions plans have grown, individuals are relying on IRAs more than ever. Similarly, as more investors receive their pension benefits in a lump sum rather than as an annuity, they are choosing to roll them into an IRA.[7] For millions of IRA

[4] Forrester Research, Inc., Trends, *Consumers Aren't Comfortable Estimating What They'll Need for Retirement,"* by Bill Doyle, April 19, 2007.
[5] Forrester Research, Inc., Trends, p. 6.
[6] Employee Benefit Research Institute, "Retirement Trends in the United States Over the Past Quarter-Century," June 2007.
[7] In 1989, 60 percent of participants received their benefit in the form of annuity. Just five years later, only 38 percent of participants received their benefit as an annuity. U.S. Department of Labor, Pension and

investors, their retirement security hinges on their ability to wisely invest their IRA assets. Knowing that, they are seeking help from investment professionals. Our annual investor survey consistently showed that investors wanted additional help in learning how to make good investment decisions. Similarly, a recent CIGNA Retirement and Investment Services confirmed that 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. The financial services industry has long been committed to meeting this pressing need for our customers and clients.

DOL's Previous Initiatives

The threat of inadequate retirement assets and the absence of investment advice and guidance led the Department in 1996 to promote investment education through its interpretative bulletin on education. The Department also issued several exemptions for investment advice, as well as the Sun America opinion letter. In Sun America, the Department held that ERISA was not violated by a fiduciary providing advice through a computer model *if* the model was created by an entity independent of the advisor. But as the Department pointed out repeatedly in support of investment advice legislation, this model simply did not work because very few investment providers adopted the models and even fewer participants actually used them.

Welfare Benefits Administration, "Retirement Benefits of American Workers, New Findings from the September 1994 Current Population Survey," September 1995.

The Department itself understands the limitations of the independent advice model, and the inability to deviate from that model. As the Department noted in its testimony before Congress in 2003:

> Current ERISA law raises barriers against employers and investment firms providing individual investment advice to workers. As a result, millions of rank and file workers do not have the information and advice necessary to make sound investment decisions to enhance their long-term security and independence.
>
> The President's Retirement Security Plan would increase workers' access to professional investment advice. By relying on expert advisers who assume full fiduciary responsibility for their counsel and disclose relationships and fees associated with investment alternatives, American workers will have the information to make better retirement decisions.

<u>PPA's Statutory Requirements</u>

PPA gave qualified advisors relief from ERISA's prohibited transaction rules to provide American workers with meaningful investment advice. To fully implement this relief for IRAs, Congress directed the Department of Labor to determine whether a computer model exists that delivers investment advice to IRA account holders that meet certain criteria. The computer model should take into account the full range of investments, including equities and bonds, in determining the options for the investment portfolios of the beneficiary. The language does not mean computer programs that only provide advice on mutual funds.

In its hearing notice, the Department stated that it "is interested in understanding what particular types of investments or asset classes a computer model program should take into account in order to provide appropriate advice to IRA beneficiaries." In framing the issue in this context, we believe the Department is attempting to substitute its judgment for that of Congress in deciding what types of investments or asset classes a model ***should*** take into account. In the PPA, Congress stated that the model ***must*** take into account the *full range* of investments available to an IRA. The statute does not provide that a computer model for IRAs need only provide asset allocation advice or advice only among mutual funds.

IRAs may invest in stocks, bonds, certificates of deposit, mutual funds, annuities, real estate, limited partnerships, and private stock, both foreign and domestic. And, there are no investment limitations imposed by the Internal Revenue Service except for investments in life insurance and collectibles, other than certain coins and bullion. On average, 41 percent of IRAs hold individual securities in addition to other types of investments such as a mutual fund. Nineteen percent of IRA account holders hold annuities in their IRAs and 27 percent hold assets in a bank savings account.[8] Indeed, in recognizing that IRAs do indeed purchase foreign securities directly, Congress specifically amended the statute to permit IRAs to purchase foreign currencies in

[8] Investment Company Institute, "Appendix: Additional Data on IRA Ownership in 2005", January 2006, p. 4

connection with the purchase, sale and holding of investments. The statute is unambiguous that the Department should take into account the full range of investments available to an IRA on an investment-by-investment basis, and not solely directed at asset classes.

The Department's notice also stated that it needs additional information on the manner in which such programs could operate without bias as to investments offered by the fiduciary advisor or an affiliate, if the particular advice program allocates IRA assets among only such investments. We believe a model could suffer from two major kinds of bias. It could unfairly allocate toward products with high fees. Or, if the model discloses that it will recommend proprietary products, the model should not be considered biased. The fact that the model is closed to nonproprietary products is readily apparent to the IRA owner who decides to use that program over an "open architecture" program. We are not concerned with this "built-in" bias as long as full disclosure is made that a model is proprietary only. Moreover, we do not believe Congress had this type of bias in mind when it mandated the Department's inquiry.

The Department's notice also sought comment on whether the scope of relief from ERISA's prohibited transaction provisions is adequate to facilitate the use of computer-based programs for IRAs should the Department determine that such programs are feasible. No model can process all potential investments that an IRA could make, especially in light of the statutory requirement that the model take into account preferences with respect to certain types of investments and historical rates of return of each potential investment. While technology continues to amaze, most knowledgeable technology experts would say we are years away from the kind of model required in this setting.

The Department's notice also sought information concerning the scope of relief and the conditions that would be appropriate if it were necessary to issue the class exemption described in PPA section 601(b)(3)(C)(ii). We believe an exemption is necessary, and we strongly urge the Department to include a disclosure based exemption that would require the advisor to acknowledge fiduciary status in writing. In addition, the statute gives authority to the Department to include an annual compliance audit of the advisory services. A compliance audit could be performed for an advice program by looking at whether policies and procedures were established and followed.

We believe that in order for investment advice to get in to the hands of those who need it, the exemptive relief needs to be simple. An overly complex exemption will make it less likely that IRA account holders will receive advice at all. The very success of investment advice is imperiled in both the 401(k) and IRA context to the extent that fee leveling is the desired approach. The computer model exemption for 401(k) plans has problems as well. After considering the matter further, we trust that the Department will determine that a computer model meeting the statutory requirements is not feasible, and that you will promptly issue a disclosure-based exemption for the provision of investment advice to IRAs.

Thank you for the opportunity to testify today and I would be happy to answer any questions you have. We hope you will not hesitate to call on us to assist you in your efforts to ensure the retirement security of American workers by providing investors with a full range of investment advice options.