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Committee on Education and the Workforce
Subcommittee on Health, Employment, Labor and Pensions

Hearing on Regulatory Barriers Facing Workers and Families Saving for Retirement

May 18, 2017

Introduction:

Chairman Walberg and Ranking Member Sablan, thank you for the opportunity to testify today regarding the regulatory barriers making it harder for working Americans to save for retirement.

My testimony today reflects my personal views as a former Federal regulator and as a current ERISA attorney, and not those of any client, of my firm, or of my colleagues. I am not testifying on behalf of any client or any other party.

I commend the Committee for holding this important hearing. All of us here today share the goal of ensuring working Americans can retire with dignity and security. In order to achieve that goal, we need to ensure that the regulations governing our retirement system are functioning efficiently and achieving their intended purposes.

The goal of efficient regulation is not just to protect participants and beneficiaries in plans, although that is an essential function. Efficient regulation in our voluntary system must also avoid stifling the creation of workplace retirement plans, and should expand access to quality investment advice and assistance so that participants in plans can make informed decisions about their financial futures. This is one of the reasons the regulatory process requires agencies to consider less burdensome alternatives to a proposed course of action—how a regulation executes the underlying policy concept has a material impact on its success or failure.

Unfortunately, we are failing in both of these areas. The cumulative weight of decades of rules and regulations is making it harder for employers—especially small employers—to offer plans. Further, we are poised to significantly increase costs and reduce access to investment advice and assistance for American workers and retirees on June 9th. That is when the Department of Labor's ("DOL") new, fundamentally flawed regulation redefining fiduciary investment advice

and its associated new and amended prohibited transaction class exemptions (collectively the "Fiduciary Rule")[1] are scheduled to become applicable.

While there are a number of solutions the Subcommittee will hear today to make it easier for employers to offer retirement plans, there is a clear and straightforward solution to the second problem. The applicability date of the Fiduciary Rule should be delayed until the DOL has completed its review of the new evidence regarding the effects of the Rule. There is now clear and convincing evidence of the harm the Rule as currently constituted will cause retirement savers, and DOL should ensure that it does not allow that harm to continue by relying out inaccurate economic predictions from the prior Administration.

The Fiduciary Rule is the Product of a Flawed Process:

The concept behind the Fiduciary Rule—ensuring retirement savers receive quality retirement advice and assistance—is a good one. The problem is that the Fiduciary Rule executes this concept very poorly. Rather than focusing on specific problems, the Fiduciary Rule fundamentally disrupts the way advice and assistance is provided to nearly 100 million people and $15 trillion.

The failures of the Fiduciary Rule are the predictable results of a flawed regulatory process that started with a policy position and then built a rationale to justify the conclusion. The basic problem is that the Fiduciary Rule equates the way an advisor is compensated with the quality of the advice, deeming certain compensation methods to be prohibited despite their extensive oversight by existing Federal, State and other regulatory and enforcement agencies. Under this structure, your financial professional might even be prohibited from making a recommendation that is in your best interest, simply because she receives a commission.

The rationale for this policy belief comes largely from narrow academic studies evaluating a certain type of conflict for a certain type of advisor for a certain type of product, and extrapolating those results across the entire spectrum of advice models and investment products. As many critics have since explained, the underlying academic studies do not themselves support the policies ultimately adopted.

Indeed, DOL partially acknowledged as much in the proposed rule delaying the applicability date by 60 days. Writing that elements of the prior economic analysis used to conclude that conflicts cost $17 billion or more annually due to long term reductions in investment returns were "uncertain and incomplete," and DOL acknowledged that they were based on a limited assessment of "one source of conflict (load sharing) in one market segment (IRA investments in front-load mutual funds)."[2]

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[1] 81 Fed. Reg. 20,945 – 21,221 (Apr. 8, 2016).

[2] 82 Fed. Reg. 12,319 at 12,320 (Mar. 2, 2017).

The 60-Day Delay was a Prudent First Step, But Further Delay is Required:

On February 3, 2017, President Trump issued a Presidential Memorandum ordering DOL to review the effects of the Fiduciary Rule on retirement savers' access to investment products and services; on disruptions to the retirement services industry affecting retirement savers; and on increased litigation risks and costs. Unlike the economic analysis that accompanied the promulgation of the Rule (based on select academic predictions), the new review will have the benefit of empirical evidence based on the efforts of the past year to understand and comply with the Rule.

In order to facilitate this review, DOL requested input from the public regarding the actual effects of the Fiduciary Rule in a comment period ending on April 17th. In addition, DOL initially approved a 60-day delay of the applicability date from April 10th to June 9th. Because of the April 10th deadline, the DOL decision to delay the applicability date by 60 days had to be made prior its receipt of the new information regarding the effects of the rule. Thus, the economic analysis of the 60 day delay remained based on the prior analysis, replicating its flaws. DOL has not yet had a chance to offer a public analysis taking into account new information—it would have such an opportunity in a subsequent regulation providing further delay.

The new empirical evidence based on actual experience shows that the academic predictions dismissing the Rule's harmful effects, such as reduced access to advice and assistance, were wrong. Advisors and financial institutions reported increasing minimum asset requirements for advisory accounts, a shift from commission-based accounts to more expensive fee-based accounts, reduced investment product offerings, increased litigation risks and compliance costs, and increased liability insurance costs.

More troubling, the Investment Company Institute reported that a survey of its members (mutual fund providers) shows an increase in the number of "orphan" accounts—shareholders who are no longer working with an advisor—as broker-dealers and other distribution partners began implementing plans to stop serving small clients. The average account balance in that survey was $17,138, representing the loss of advice and assistance to the very retirement savers the Rule should be protecting, and who are most in need of assistance.

This new evidence should not have come as a surprise—during the development of the final Fiduciary Rule, even other Federal agencies publicly raised concerns about increased costs. The Small Business Administration's ("SBA") Office of Advocacy expressed concerns in its formal comment letter to the Department, questioning the Department's economic analysis and criticizing the Department for not sufficiently taking into account the effects of the Proposal on small businesses. The conclusion from focus groups held by the SBA was that "the proposed rule would likely increase the [advisers'] costs and burdens associated with serving smaller plans…[and] could limit financial advisers' ability to offer savings and investment advice to clients…ultimately lead[ing] advisors to stop providing retirement services to small businesses."[3]

[3] Comment letter from the Small Business Administration's Office of Advocacy, July 17, 2015, at 5-6.

The Fiduciary Rule should be delayed until a complete review of this new, compelling evidence is complete.

Lack of Access to Advice and Assistance Hurts Retirement Savers:

The reality (which is largely ignored by the prior economic analysis) is that not having access to investment advice and assistance hurts retirement investors regardless of their financial professional's compensation methods. These losses actually cost far more than the $17 billion the DOL Fiduciary Rule analysis predicted the Rule would save. According to a Vanguard study, individuals receiving professional investment assistance have as much as a 150 basis point increase in compound returns, due in large measure to the encouragement they receive to contribute more to retirement savings and to make other changes to their financial habits.[4] This highlights the fact that working with a professional is about more than picking investments—it is about a relationship that includes education and other financial assistance, no matter how the professional is paid.

In fact, DOL itself evaluated the costs associated with of lack of access to advice in an earlier regulation. In 2011, the Department issued a final regulation implementing certain investment advice provisions of the Pension Protection Act of 2006 ("PPA"). In the economic analysis related to the final rule, the Department quantified the losses resulting from a lack of advice at more than $100 billion per year, and determined that these losses were due, in part, to the prohibited transaction and fiduciary rules of the Employee Retirement Security Act of 1974 ("ERISA").[5] In describing these concerns, the Department wrote:

> "Unfortunately, there is evidence that many participants of these retirement accounts often make costly investment errors due to flawed information or reasoning…Financial losses (including foregone earnings) from such mistakes likely amounted to more than $114 billion in 2010…Such mistakes and consequent losses historically can be attributed at least in part to provisions of the Employee Retirement Income Security Act of 1974 that effectively preclude a variety of arrangements whereby financial professionals might otherwise provide retirement plan participants with expert investment advice."[6] [Emphasis added]

Yet the same mechanism the DOL noted limits access to needed advice and assistance is the basic mechanism utilized by the fiduciary rule to determine and prohibit conflicts. The effect is further magnified by the fact that enforcement of the prohibited transaction rules in the IRA marketplace is outsourced to private litigants in state-based class actions. Opening the door to a new round of class action litigation fueled by contingency fees is not an efficient means of

[4] "Putting a Value on Your Advice: Quantifying Vanguard Advisor's Alpha." Vanguard Research, September 2016.

[5] *See,* The Preamble to the final regulation implementing the Pension Protection Act investment advice provisions, 76 Fed. Reg. 66,151-66,153 (October 25, 2011).

[6] Preamble at 76 Fed. Reg. 66,151.

regulating the retirement system (though it does siphon scarce retirement resources to the trial bar).

Given the new evidence demonstrating the harm to retirement savers that is already taking place even before the Fiduciary Rule has become officially applicable, the Fiduciary Rule should be delayed until the DOL can completed its review and decide what next steps to take. If the Fiduciary Rule goes into effect as scheduled, not only will some retirement investors lose access to advice and assistance, but any future changes by DOL will result in further investor confusion and dislocation due to a second round of compliance changes.

Little Internal Oversight of the Regulatory Process:

The Office of Management and Budget ("OMB") serves a number of functions in the regulatory process, but one of its central roles is to enforce the process requirements, including ensuring that the economic analysis informs the development of the policy rather than simply justifying policy decisions already made. While this may work for lower-level regulations, there is an inherent conflict of interest in that OMB and its Office in Information and Regulatory Affairs ("OIRA") are part of the Executive Office of the President. Thus, where a regulation is a Presidential priority, OMB is much less likely to neutrally impose meaningful standards and control on the process.

The Fiduciary Rule is a good example of this process breaking down—White House officials involved in the policy decisions regarding the content of the Rule were also were involved in the economic analysis justifying the Rule. The result was an economic analysis of great length but with a decidedly one-sided view of the issues.

Why is the Fiduciary Rule Causing Such Disruption to Retirement Savings Arrangements?

Part of the reason the Fiduciary Rule is having such a negative effect on access to investment advice and assistance is because DOL is applying a fiduciary standard based on ERISA's regulation of employer provided plans to the Individual Retirement Account ("IRA") marketplace. The ERISA framework does not fit the IRA marketplace, and the IRA marketplace was never designed or regulated in a manner consistent with ERISA's requirements. ERISA plans and IRAs are fundamentally different, despite receiving similar tax treatment.

Congress did not intend for DOL to be the sole regulator of the conduct and compensation of various types of financial advisors to IRAs, or for the ERISA fiduciary standard (which is the basis for the Rule's Best Interest standard) to apply to IRAs. When Congress created ERISA plans and IRAs in 1974, it chose NOT to apply the ERISA fiduciary standard to IRAs, although DOL has had interpretive authority over the prohibited transaction rules since 1978.

This Congressional decision makes sense—in an ERISA plan, a fiduciary makes many decisions for participants, and thus a fiduciary standard rooted in trust law strictly governs how he or she makes decisions on another's behalf. By contrast, the IRA owner makes his or her own decisions, so Congress treated IRAs much as it treated other types of investment vehicles, and

relied on the extensive network regulators and laws already protecting investors and regulating various types of financial professionals.

Congress created a new private right of action and new legal remedies for ERISA plans, but did not create a special cause of action for IRAs. Rather than create an IRA-only cause of action, Congress let recourse against investment professionals be determined by the Federal and State regulation applicable to the type of professional.

The Fiduciary Rule establishes a standard of care for advice to IRA's and a cause of action through exemptions to the prohibited transaction rules. As a result of the expanded definition of fiduciary advice, perfectly legal and common commission-based compensation arrangements for registered representatives and insurance agents helping IRA owners will become, in one fell swoop, illegal prohibited transactions. DOL then provides special rules, the aforementioned exemptions, that permit some limited commissions, but only if they meet special conditions, including new class action litigation risks.

This approach to remaking the IRA marketplace not only requires massive change that is negatively affecting many IRA owners for whom the current system is more advantageous, but it presumes that the quality of the advice is determined by the compensation method. This leads to the odd result that advice that is in your best interest may be illegal for your advisor to give, simply because of how she is paid.

For example, under the current Fiduciary Rule, as of January 1, 2018, an insurance agent will be unable to recommend a fixed index annuity to you because her commission is a prohibited transaction for which there is currently no exemption. It doesn't matter whether that recommendation is best for you or not—her compensation, not your best interest, determines her ability to discuss it with you.

In summary, by prohibiting the way certain financial professional have historically been paid if they give advice regarding ERISA plans, IRAs, rollovers and distributions, and by then offering them a narrow way out through an exemption with extensive conditions, the Fiduciary Rule foists onto investors and their financial professionals a system Congress affirmatively chose not to impose.

<u>Improving Access to Retirement Plans in a Voluntary System:</u>

According to DOL data, there are about 90 million active participants in ERISA-covered pension plans, and such plans hold more than $8 trillion in assets.[7] While these are very large numbers that show the significance of these plans to retirement savings, they do not tell the whole story. Larger businesses are more than three times more likely to offer retirement benefits than small businesses.[8] This is in part because it takes a lot of work and attention to regulatory detail to

[7] "Private Pension Plan Bulletin, Abstract of 2014 Form 5500 Annual Reports," Employee Benefits Security Administration, U.S. Department of Labor, September 2016.

[8] "Employer-Based Retirement Plans: Access Varies Greatly," The Pew Charitable Trusts, May 27, 2016. Surveys show "…only 22 percent of workers at companies with fewer than 10 employees report having access to workplace retirement plans, compared with 74 percent of workers at businesses with at least 500 employees."

offer a retirement plan.   The 401(k) may be the most common type of plan, but that does not mean it is easy or simple to administer.

The cumulative effect of decades of regulation and legislation has increased the burden on employers sponsoring retirement plans, making it more difficult—especially for small employers—to offer retirement plans to their workers. While well-intentioned, the growth of rules and requirements over time has increased significantly the complexity of administering retirement plans. Though some simplified plan designs are available to small employers that reduce the administrative complexity, they also come with real restrictions, such as reduced limits on the amount workers and employers can contribute to the plan.

Rather than accept this status quo, Congress and Federal regulators could remove some of these burdens without sacrificing worker protections, improving regulatory efficiency. For example, Multiple Employer Plans would make it easier for small businesses to offer well-run plans with a centralized, professional compliance team, eliminating the need to “recreate the wheel” at each plan sponsor. DOL could review and harmonize the various disclosure and reporting requirements that are not currently well-coordinated, resulting in a nearly constant need for plan activity related to different events and deadlines. DOL could also permit default electronic disclosures, saving a significant amount of time, money and paper.

Conclusion:

Thank you Mr. Chairman and Ranking Member Sablan for your commitment to improving our retirement system. I hope that you will also impress on your colleagues on the Ways and Means Committee the importance of preserving the tax treatment of qualified plans and IRAs as they consider comprehensive tax reform. 401(k)s and IRAs are for Main Street, not Wall Street, and we should encourage more retirement savings, not less.