THE FINANCIAL SERVICES ROUNDTABLE

Financing America's Economy

PROTECTING AMERICANS' RETIREMENT SAVINGS

STATEMENT FOR THE RECORD

On

The U.S. House Committee on Financial Services, Subcommittee on Capital Markets and Government Sponsored Enterprises hearing entitled:

"Ensuring Appropriate Regulatory Oversight of Broker-Dealers and Legislative Proposals to Improve Investment Adviser Oversight"

September 13, 2011

The Financial Services Roundtable[1] ("Roundtable" or "we") appreciate the opportunity to provide our views on a matter of high importance for Americans who are saving for their retirements. The Roundtable believes that providing these opportunities for all Americans to plan and save for their retirement years is important because savings increase domestic investment, encourage economic growth, and result in higher wages, financial freedom, and a better standard of living. We believe that most Americans should approach retirement with a comprehensive strategy that incorporates a number of retirement vehicles. Consumer education about retirement savings products can help consumers make sound investment decisions and provide opportunities for them to maximize their retirement savings. Further gains can be achieved through better use of investment advice, and by promoting policies that provide for more diversified, dynamic asset allocation, and exploration of new and innovative methods to help individuals make better investment decisions.

The Need for a Uniform Approach

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). Section 913 of the Dodd-Frank Act generally charged the Securities and Exchange Commission with studying the obligations of broker-dealers and investment advisers (the "Report").[2] Among other things, the Dodd-Frank Act required the Commission to evaluate the effectiveness of existing legal or regulatory standards of care for securities professionals (brokers, dealers, investment advisers, *etc*.) who provide personalized investment advice and recommendations about securities to retail customers. In its review of standards of care for securities professionals, the Commission also was required to evaluate whether existing legal or regulatory standards have "gaps, shortcomings, or overlaps" in the protection of retail customers. The Commission submitted its Report to Congress on January 22, 2011.[3]

In its Report, the Staff recommended that the Commission promulgate a uniform fiduciary standard of conduct for broker-dealers and investment advisers who provide personalized investment advice about securities to retail customers and such other customers as the Commission determines.[4] In accordance with Section 913, the

[1] The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $ $92.7 trillion in managed assets, $1.2 trillion in revenue, and 2.3 million jobs.

[2] Pub. Law No. 111-203, § 913(f), 124 Stat. 1376, 1828 (July 21, 2010).

[3] SEC. & EXCH. COMM'N, *Study on Investment Advisers and Broker-Dealers: As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Jan. 2011) (the "Report"). The Commission did not express any view concerning the Staff's analysis, findings or conclusions.

[4] *See id.* at 109-10.

Staff recommended that the Commission define the standard of care as a duty "to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice."[5] As part of its rulemaking, the Staff further recommended that the Commission address not only the components of a uniform fiduciary standard (*i.e.*, the duties of loyalty and care), but that it also provide guidance on specific scenarios to assist broker-dealers in transitioning to the new standard.

In the interim, the Department of Labor proposed to re-define the definition of the term *fiduciary*[6] for purposes of Title I of ERISA[7] (the "Proposal"). Many of the issues we expect the Commission to address in its uniform fiduciary standard (*e.g.*, proprietary trading, compensation, and sales of proprietary products) also would impact financial services firms and professionals who would be deemed *fiduciaries* for purposes of ERISA. Accordingly, it is critical that the Department and the Commission work together to develop a practical approach that not only provides appropriate protections for investors, but also preserves each investor's ability to choose its service provider(s) and accommodates a range of business models.

The Roundtable is a long-standing supporter of harmonizing regulations applicable to broker-dealers and investment advisers who provide personalized investment advice and recommendations about securities to retail customers. We also support legal and regulatory protections for retail investors and capital markets.

Consistent with Congress's interest in developing a uniform standard of care, we believe that these worthy goals can be achieved without subjecting broker-dealers and investment advisers to costly, duplicative, and overlapping regulatory régimes that create confusion among investors, and do not recognize or allow for differences in the business models, services, and products provided by a range of financial services firms and professionals. The Roundtable also is concerned that the Department's proposal would impose a uniform duty of care on a subset of the financial services industry that would further increase investor confusion about the standard of care owed to them by their financial professionals, and impose an additional unnecessary—and expensive—layer of regulation on financial services firms and professionals.

We also note the differing approaches to potential conflicts of interest by the Department and the Commission. The Department generally prohibits potential conflicting interests, unless an exemption is available for the service provider's activities. However, the Commission's regulations may allow broker-dealers and

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[5] *Id.* at vi.

[6] DEPT. OF LABOR, *Definition of the Term "Fiduciary,"* 75 FR 65263 [RIN: 1210—AB32] (Oct. 22, 2010) (the "Proposing Release").

[7] Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1001, *et seq.*

investment advisers to manage potential conflicting interests by full disclosure to the customer and obtaining the customer's written consent to those potential conflicts.[8]

The two agencies are going down parallel tracks to address the same issues in sharply divergent ways. The Department is expanding the definition of fiduciary while preserving rules that would prohibit standard compensation practices in the broker-dealer industry. As proposed, disclosures of such practices could not cure a conflict of interest, although disclosure is a key element of the Commission's regulation of investment advisers and broker-dealers.

Accordingly, the Roundtable urges the Department to withdraw its rulemaking and to work collaboratively with the Commission (and other financial and banking regulators) to develop a harmonized definition of "fiduciary" and concomitant regulatory régime for all market participants, but particularly for those overlapping activities related to individual retirement accounts ("IRAs") and small business retirement plans.[9]

Notwithstanding the Roundtable's request that the Department withdraw its current version of the proposed definition of *fiduciary*, our Members fully support the Department's initiative to modernize the regulation and provide definitive guidance for the financial services and retirement planning industry to ensure that plan participants and beneficiaries have clear and concise information.

The Department's Proposed New Definition of *Fiduciary*

As proposed, a service provider would become a *fiduciary* if it provides *investment advice* or *recommendations* to an employee benefit plan, and *receives any compensation* (direct or indirect fees, *etc*.) for that advice or those recommendations.[10] Any service provider who provides *advice* on the *value or*

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[8] *See, e.g.,* Rules 206(3)-2 and 206(3)-3T under the Investment Advisers Act of 1940.

[9] The Roundtable further notes that a broker-dealer that is deemed to be a fiduciary becomes subject to a minimum net worth standard under of the Internal Revenue Code that operates independently of the minimum net capital requirement for broker-dealers specified by Rule 15c3-1(a) under the Securities Exchange Act of 1934. *Compare* 26 C.F.R. § 1.408–2(e)(5)(ii)(B) (imposing a net worth requirement of the greater of $100,000, or four percent of the value of all of the assets held in fiduciary accounts); *with* 17 C.F.R. § 240.15c3-1(a)(1)(ii) (requiring broker-dealers that calculate net capital under the alternative method to maintain net capital of not less than the greater of $250,000 or two percent of aggregate debit items computed in accordance Rule 15c3-3A, 17 C.F.R. § 24015c3-3A). Accordingly, we urge that the DOL and the SEC not work not only together to address these issues, but also confer with the Internal Revenue Service to address and avoid overlapping and inconsistent regulations.

[10] *See*, § 2510.3–21(c) Definition of *Fiduciary*, 75 FR at 65277. In another significant change, a service provider also would become a fiduciary if it provided any advice or recommendations to any plan participant or beneficiary. *See* Proposing Release, 75 FR at 65266 (citing Proposed rule 3-21(c)(1)(i)(B)). As a consequence, plan participants and beneficiaries could avail themselves of a private right of action under

investment of ERISA plan assets,[11] or who provides *advice* on the *management of plan assets* also would become a fiduciary.[12]

In an important change from the current rule originally promulgated in 1975,[13] the Proposal would not require that the parties (plan sponsor, participants or beneficiaries and the financial services provider) to reach a mutual understanding to establish a fiduciary relationship.[14] Nor would the Proposal require that the advice "be provided on a regular basis."[15] Finally, the Proposal also would expand the *fiduciary*-definition to individual retirement accounts ("IRAs"), which to this point have not been generally covered by ERISA.[16]

The Department's current definition of investment advice for purposes of determining one's fiduciary status is practically identical to the federal securities law definition of "investment adviser."

The Department's current rule shares many similarities with the definition of "investment adviser" in section 202(a)(11) of the Investment Advisers Act of 1940:[17]

> "Investment adviser" means any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation

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ERISA section 502(a)(2) against any plan fiduciary who breaches "responsibilities, obligations, or duties" arising under Title I of ERISA. *See* Proposing Release, 75 FR at 65273, n.32.

11 Proposed rule 3-21(c)(1)(i)(A)(1).

12 Proposed rule 3-21(c)(1)(i)(A)(3). *See* Proposing Release, 75 FR at 65266 (managing securities or other property also includes exercising rights appurtenant to particular securities, such as voting proxies).

13 *Definition of "Fiduciary,"* 29 C.F.R. § 2510.3-21, 40 FR 50842 (Oct. 31, 2975) (establishing a "five-part test" to determine whether an ERISA service provider is a fiduciary because it renders "investment advice" to an ERISA plan). The elements of the current five-part test focus on whether an advisor who does not have discretionary authority or control over an ERISA plan's assets: (1) Provides *advice* concerning the *value* of—or makes *recommendations* as to the *advisability* of investing in, purchasing, or selling—securities or other property; (2) on a *regular basis*; (3) pursuant to *a mutual agreement*, arrangement or understanding with the plan or plan fiduciary that (4) the *advice* will serve as a *primary basis for investment decisions* concerning plan assets; and that (5) the *advice* will be *individualized* based on the *particular needs of the plan. See Definition of "Fiduciary,"* 29 C.F.R. § 2510.3-21(c) (2010).

14 Proposing Release, 75 FR at 65267 ("The proposal also does not require that the parties have a mutual understanding that the advice will serve as a primary basis for plan investment decisions.").

15 *See* Proposing Release, 75 FR at 65267 (distinguishing the Proposal from the provisions of current rule 3-21(c)(1)(ii)(B) [29 C.F.R. § 2510.3-21(c)(1)(ii)(B) (2010)]).

16 *See* Proposed rule 3-21(c)(4) [29 C.F.R. § 2510.3-21(c)(4)]; Proposing Release, 75 FR at 65269 (applying the proposed definition of *fiduciary* to "any plan described in Code section 4975(e)(1), regardless of whether such plan is an employee benefit plan"). Section 4975(e)(1) includes individual retirement accounts within the meaning of section 408(a) of the Internal Revenue Code [26 U.S.C. § 408(a) (2010)].

17 15 U.S.C. § 80b-1 *et seq.* (2010).

and as part of a regular business, issues or promulgates analyses or reports concerning securities.[18]

It is apparent that the Department does not understand the very capital markets it now seeks to regulate with the Proposal. For example, the staff wants to apply the definition of *investment adviser* under the Advisers Act in its regulations under ERISA independently of how the Commission would define the very term it promulgated under the Advisers Act. And yet the Commission is the statutorily-authorized regulator of the nation's capital markets, and the brokers, dealers, investment advisers, investment companies, and other registered market participants.

The Proposed definition poses several interpretative and practical challenges that are likely to reduce significantly the availability of retirement advice for American consumers.

The meaning of *investment advice or recommendations* is so broad that the Proposal will cover many persons and entities that do <u>not</u> offer *investment advice* or *recommendations*. For example, a person who *appraises* or provides any *valuation* of an ERISA benefit plan's assets would become a *fiduciary* to the plan.[19] A custodial bank that merely <u>reports</u> the valuation provided by third-party pricing services of the plan's real estate, venture capital interests, swaps, or other *hard-to-value assets* on periodic plan statements or in performance measurement reports also would become a *fiduciary*. The Proposal also would bring within the ambit of ERISA fiduciary status:

- Any bank or securities firm that holds assets "as trustee" for an IRA.
- Computer programmers who write software code for asset allocation models or other financial strategies.
- Call Center employees who inform ERISA plan participants and beneficiaries of their alternatives upon retirement, resignation, layoffs, marriage, birth of a child, *etc*.[20]

By increasing substantially the categories of service providers who would be deemed *fiduciaries* for purposes of ERISA, the Department's Proposal would directly

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[18] 15 U.S.C. § 80b-2(11) (2010).

[19] *See* Proposed paragraph (c)(1)(i)(A)(1) of rule 2510.3-21. The Department stated the proposed definition would include "appraisals and fairness opinions." Proposing Release, *supra* note 7 at 65265. *Appraisers*—like external auditors—are required to be *independent* of the parties seeking an appraisal. Under the current definition of fiduciary, it would not be possible for a person who is the ERISA plan's fiduciary to also provide "appraisals" or "valuations" of assets held in any ERISA plan for which it also acts as the plan's fiduciary. Moreover, a requirement that the appraiser be independent of the ERISA plan would avoid "the fox minding the chicken coop" risk to ERISA plan participants and beneficiaries. However, by re-defining appraisers as "plan fiduciaries," the Proposal would engraft a patent conflict of interest onto any valuation or appraisal conducted by the plan fiduciary.

[20] This information would be extracted from the ERISA benefit plan disclosure documents that are distributed to all plan participants and beneficiaries.

increase the cost of providing retirement services and thereby decrease the availability of retirement planning options for all Americans.[21] The Department's Proposal also would lead to a "[r]educed choice of investment professional, level of investment guidance, and investment products."[22]

The Department's economic and cost-benefit analyses provide inadequate justification for wholesale revisions to the current definition of *fiduciary*.

Despite 35 years of experience with the *current definition of fiduciary*,[23] the Department's economic and cost-benefit analyses provide inadequate justification for its wholesale revisions to the current definition. The Department did not evaluate the *economic impact on small business* owners and small plan sponsors, who are unlikely to absorb the *potentially substantial increase in costs* arising from the expanded definition of *fiduciary*. This oversight is particularly troublesome in today's recessionary economic environment.

The Department now uses the results of a January 2011 GOVERNMENT ACCOUNTABILITY OFFICE *Study on 401(k) Plans*[24] to justify a rule it proposed three months earlier—in October 2010. The Department did not conduct *any* study or survey—or provide *any data*—on the *projected impact or effect on IRA owners* or IRA service providers before it proposed this *substantial change*. Nor did the Department provide any objective, quantifiable data to support its conclusion "that the proposed regulation's benefits would justify its costs."[25]

The Department's stated rationale for its Proposal is to pursue *bad actors* (*i.e.*, pension consultants and appraisers) who allegedly have provided substandard services and who failed to recognize or disclose conflicts of interest.[26] If this is the goal, then

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21 *See* Oliver Wyman, Inc., OLIVER WYMAN REPORT: ASSESSMENT OF THE IMPACT OF THE DEPARTMENT OF LABOR'S PROPOSED "FIDUCIARY" DEFINITION RULE ON IRA CONSUMERS at 19-20 (Apr. 12, 2011) (the "OLIVER WYMAN REPORT"). The OLIVER WYMAN REPORT is based on aggregate proprietary data furnished by "[twelve] financial services firms that offer services to retail investors." *Id*. at 1. These firms "represent over 19 million IRA holders who hold $1.79 trillion in assets through 25.3 million IRA accounts [or roughly forty percent (40%) of IRAs in the United States and forty percent (40%) of IRA assets]." *Id*.

22 *Id*. at 19.

23 40 FR 50842 (Oct. 31, 1975). *See also*, Mercer Bullard, *DOL's Fiduciary Proposal Misses the Mark* (June 14, 2011) ("It is unfair to the industry because it disregards decades of administrative law and practice under ERISA. It is bad for investors because it strips them of fiduciary protections when they are needed most.").

24 GOVERNMENTAL ACCOUNTABILITY OFFICE, *401(k) Plans: Improved Regulation Could Better Protect Participants from Conflicts of Interest*, GAO-11-119 (Jan. 28, 2011).

25 Proposing Release, *supra* note [ ] at [page number].

26 Proposing Release, *supra* note 7 at 65271 (citing a Securities and Exchange Commission staff report that found a majority of the 24 pension consultants examined in 2002-2003 "had business relationships with broker-dealers that raised a number of concerns about potential harm to pension plans"); SEC. & EXCH. COMM'N, *Staff Report Concerning Examinations of Select Pension Consultants* (May 16, 2005); GAO, *Private*

the Department should more narrowly tailor the proposed changes to reach those particular bad actors.

Moreover, the Department should *collaborate* with the Securities and Exchange Commission, Commodity Futures Trading Commission, Municipal Securities Rulemaking Board, FINRA, the Office of the Comptroller of the Currency, and other financial regulators to address gaps it perceives in oversight of broker-dealers, banks, trust companies, and similar service providers who already are subject to significant regulation.

The Department also should consider whether other regulations (including those enforced by financial or banking regulators) already provide adequate safeguards. For example, the Department's recent disclosure regulations will require pension consultants to disclose all direct and indirect compensation they receive before entering into a service arrangement with a plan.[27]

The *effects* of the Department's *collaboration* with financial and banking regulators to implement a regulatory régime that provides clarity and certainty *for investors and markets* should be *transparent*. *Conflicting rules create* *confusion* *for investors*, increase costs to service providers, and lessen the availability of retirement services overall.

Conclusion

We support the Department's initiatives to better protect plan participants and beneficiaries, and investors in IRAs and other retirement accounts. The Roundtable believes that the conflicting perspectives on broker-dealer compensation further support our view that the Department and the Commission should work closely together to address the definition of "fiduciary" as it is proposed to apply to broker-dealers and investment advisers—irrespective of whether the activity is one regulated by ERISA or by federal securities laws.

Given that Congress specifically charged the Commission to study the regulation of broker-dealers and investment advisers and to engage in rulemaking necessary to address any gaps or shortcomings in their regulation,[28] we believe that

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Pensions: Conflicts of Interest Can Affect Defined Benefit and Defined Contribution Plans, GAO-09-503T, Testimony Before the Subcommittee on Health, Employment, Labor and Pensions, Education and Labor Committee, House of Representatives at 4 (Mar. 24, 2009) (noting that 13 of the 24 pension consultants examined by the Securities and Exchange Commission's staff "had failed to disclose significant ongoing conflicts of interest to their pension fund clients").

[27] DEPT. OF LABOR, Fiduciary Requirements for Disclosure in Participant-Directed Individual Account Plans; Final Rule [RIN: 1210—AB07], 75 FR 64910 at 64937 (Oct. 20, 2010).

[28] *See* Section 913 of the Dodd-Frank Act.

the Commission, and not the Department, should be the lead-agency charged with promulgating any regulations that potentially could change in a fundamental way the manner in which broker-dealers and their registered representatives are compensated. We believe that regulatory changes in this area should reflect the findings of the section 913 study, and warrant a collaborative approach by the Department, the Commission, and other financial regulators in light of the complexity of the issues, the potential far reaching scope and implications of the rulemakings by the Department and the Commission, and the risk of inconsistent and overlapping regulation.

Since the Department and the Commission are at the threshold of introducing momentous changes to the regulation of entities deemed to be fiduciaries under ERISA as well as federal securities laws, the Roundtable believes it is imperative that the Department withdraw its proposed rulemaking so that the Department and the Commission can work together to harmonize the regulation of fiduciaries that are subject to ERISA and the federal securities laws.

The Roundtable thanks the the Chairman, the Ranking Member, and the Subcommittee for the opportunity to provide the views of its Members on the adverse impact of the Department's proposed re-definition of the term *fiduciary*. We stand ready to work with you, and with the Department, the Commission, and other financial regulators to develop regulatory responses that protect our customers and markets, and allow us to provide a full-range of investment products and services to our customers.