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Before

The U.S. House of Representatives
Committee on Financial Services
Subcommittee on Financial Markets

Hearing on Examining the DOL Fiduciary Rule: Implications for Retirement Savings and Access

January 10, 2024

Introduction:

Chair Wagner, Ranking Member Sherman, thank you for the opportunity to testify today regarding the Department of Labor's proposed regulation redefining fiduciary investment advice under the Employee Retirement Income Security Act of 1974 ("ERISA"), and proposed amendments to associated prohibited transaction class exemptions (collectively, the "Proposals").

My testimony today reflects my personal views, 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, and I am not being paid in connection with my testimony today.

My Background:

I currently am a practicing ERISA attorney who routinely advises employers sponsoring retirement plans on fiduciary issues, including plan investment responsibilities. I also advise financial institutions and financial professionals who assist these plans in making investment decisions, and thus who may also be subject to ERISA's requirements. From 2006 to 2009, I had the privilege to serve as the U.S. Assistant Secretary of Labor for Employee Benefits, where I led the Employee Benefits Security Administration, the primary regulatory and enforcement agency overseeing the fiduciary, prohibited transaction and reporting obligations of ERISA.

I have spent the last 20 years of my professional career focusing on the issues of fiduciary conduct, prohibited transactions, and prohibited transaction exemptions that are at the heart of the Department of Labor's ("DOL") Proposals, and I appreciate the opportunity to share my observations on the implications of the Proposals.

Importance of the Hearing:

I want to start by commending the Subcommittee for holding this hearing today, because simply by doing so, you have illustrated one of the fundamental problems with the Department's Proposals—the agency doesn't have the legal authority to do what it is trying to do.

If the Proposals were limited to redefining fiduciary advice within the Department's actual authority—which is to administer the fiduciary standard expressly created by Congress to regulate employee benefit plans sponsored by private sector employers under Title I of ERISA—we wouldn't be here today. Such a proposal would be a matter for the Education and the Workforce Committee, unrelated to broader concerns about its effect on capital markets and the responsibility of the Financial Services Committee to regulate insurance, securities, and banking. But that is not what the Proposals do.

The Proposals Would Create Conflicting Regulatory Regimes Reducing Consumer Access to Financial Professionals:

The reason we are here today is that the Proposals go well beyond DOL's limited authority. In fact, the Proposals would make DOL the primary financial regulator of $26 trillion, approximately half of which is held by individuals in individual retirement accounts and annuities ("IRAs") rather than employer-provided plans.[1] As explained below, these individual accounts generally are not subject to a DOL-imposed standard of care, or to the extensive conditions of the exemptions envisioned in the Proposals. Instead, these individuals currently receive financial assistance from insurance, securities and bank professionals subject to this Committee's jurisdiction. If the Proposals were finalized, and those individual accounts were subjected to the Department's authority in a manner similar to employer-provided plans, those insurance, securities and bank professionals serving them would now have to comply with a new, highly detailed, and very proscriptive Federal regulatory regime led by the Labor Department that would simultaneously apply with—and in many cases, materially conflict with—the requirements of their "normal" state insurance regulation, state and Federal securities regulation, or state and federal banking regulation.

The effect of this would be highly disruptive. Business models and methods of providing and paying for services currently permitted by state and federal laws would not be permitted under the DOL Proposals. With respect to the roughly $13 trillion in individual retirement accounts and annuities, financial professionals and their financial institutions would have to comply with two simultaneously applicable but different sets of requirements. This the opposite of efficient regulation that seeks to reduce the regulatory burden, recognizing that it is ultimately paid for by the end consumer—it is heavy-handed regulation that will reduce available service models for retirement savers, increase costs and risks for financial professionals, and, inevitably, reduce access and choice for small balance retirement savers.

In 2016, DOL's Rule that asserted this same type of jurisdiction over individual retirement savers did have such a negative effect. The 5th Circuit Court of Appeals noted in its ruling vacating the 2016 Rule that, "The Fiduciary Rule has already spawned significant market consequences, including the withdrawal of several major companies…from some segments of

[1] "By the first quarter of 2022…IRAs held $13.2 trillion in assets, private defined contribution plans held $9.2 trillion, and private defined benefit plans held $3.7 trillion in assets." Preamble to Definition of Fiduciary Advice Proposal, 88 Fed. Reg. at 75,915.

the brokerage and retirement investor market. [Other] companies…have limited the investment products that can be sold to retirement investors."[2]

I can personally attest to this unfortunate consequence. Like many Americans, I have several retirement accounts and have not consolidated all of them into one account. One of my accounts is a relatively small balance IRA in which I work with a broker-dealer compensated on a transaction basis. This transaction-based cost structure is to my advantage as I make infrequent transactions. After the 2016 Rule went into effect, my broker-dealer explained that they could no longer provide investment recommendations to my small account IRA—they would take orders, but could not make recommendations. After the rule was vacated in 2018, they were again able to provide investment recommendations.

There is a certain irony in the fact that the DOL rule intended to help retirement savers actually caused me—the former head of the agency—to lose access to investment assistance. Fortunately, I had other accounts and could still gain access to assistance via other means, but most persons with small account balances are not so lucky.

The ERISA Statute Regulates Employer Plans Under Title I Differently than IRAs Under Title II—DOL Can't Change that by Regulatory Action:

When Congress passed ERISA in 1974, it created two distinct types of retirement savings vehicles with two distinct sets of rules. While both enjoy special tax advantages designed to encourage retirement savings, they are not otherwise regulated in the same way.

Title I of ERISA governs employer-provided retirement plans, and Title II of ERISA governs individual savings vehicles, such as IRAs. Title I includes a fiduciary standard of care, and creates a new cause of action to enforce rights under the plan—in Title I, DOL is directly authorized to enforce the fiduciary standard and to bring legal actions.

Title II of ERISA does not contain a standard of care, it does not create a new cause of action, and it does not authorize DOL to do so. This was not an oversight or sloppy drafting—it was an intentional design by Congress. Or as the 5th Circuit wrote in vacating DOL's 2016 Rule, "Title II did not authorize DOL to supervise financial service providers to IRAs in parallel with its power over ERISA [Title I] plans."[3]

It's easy to understand why Congress made this decision.

In employer-provided retirement plans, fiduciaries make decisions for plan participants over which the participants have little or no control. Fiduciaries decide what investments are available. Fiduciaries decide which service providers to hire. Fiduciaries decide how much the plan costs. To ensure that fiduciaries make these decisions about "other people's money" properly, Congress used trust law as a foundation, and ERISA fiduciary duty became a specifically adapted form of traditional fiduciary trust obligations.

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[2] *U.S. Chamber of Commerce v. U.S. Department of Labor*, 885 F.3d 360 at 368 (5th Cir. 2018).

[3] *Chamber* at 364.

However, in the individual retirement accounts created by Title II, IRA owners make their own decisions. You decide what kind of a financial professional you wish to consult—if any. You decide what services you want, and what cost model is best for your own needs. Congress did not create a new standard of care governing advice to IRA owners or create a new cause of action because the financial professionals an IRA owner may consult were already regulated by the applicable state or federal insurance, securities, or banking regulators. Put simply, individual retirement savings vehicles already fit into the existing system of financial regulation overseen by this Committee, and did not need special rules. The primary difference between IRAs and other kinds of individual financial accounts was their advantageous tax treatment—Congress otherwise wrote the statute to comport with existing financial services regulation.

There is one common element shared by Title I and Title II—the prohibited transaction rules. These are largely parallel provisions in ERISA Sec. 406 and IRC Sec. 4975 that prevent employer plan fiduciaries and individual IRA owners from engaging in abusive behavior. For Title I plans, these rules prevent fiduciaries from taking advantage of their control over the plan to benefit themselves. For example, the fiduciary is prohibited from getting a personal benefit when making a plan decision, such as a bribe. For Title II individual accounts, these rules serve to prevent IRA owners from gaming the tax system, such as by hiding personal assets and earned income inside of the IRA. However, these prohibited transaction rules are the vehicle that the DOL Proposals use to try to regulate individual accounts.

5th Circuit Rejects the DOL Two-Step:

The Proposals, as did the 2016 Rule, use a regulatory two-step process to achieve indirectly the regulation of IRAs that Congress denied DOL the authority to impose directly.

The first step is to expand the definition of fiduciary so widely as to include nearly all recommendations by financial professionals to any plan, IRA, or in connection with any related rollover, transfer or distribution. This expanded definition makes the financial professional's normal compensation a prohibited form of self-dealing, because the fiduciary advice is causing the professional to get a new or different fee or commission.

The second step is to put out an exemption to the newly created prohibited transaction that allows the financial professional to give the recommendation and to receive a fee, but only after complying with many new conditions applicable to the transaction. In the Proposals, DOL requires the financial professional to comply with a best interest standard of care that is nearly identical to the Title I fiduciary standard of care as a condition of the exemptions. In other words, despite clear Congressional intent otherwise, the Proposals seek to sneak a fiduciary standard through the back door that DOL cannot bring in through the front door.

The 5th Circuit rejected this argument when vacating the 2016 Rule, because doing so was improperly requiring "…insurance salespeople [to] assume obligations of loyalty and prudence only statutorily required of ERISA plan fiduciaries"[4] under Title I.

[4] *Chamber* at 382.

Attempting to Distinguish the 5th Circuit's Ruling:

DOL argues that the Proposals are different than the 2016 Rule, and were modified to reflect the ruling by the 5th Circuit that DOL can't regulate sales activity as if it were fiduciary activity. DOL seeks to achieve this by defining the new fiduciary test as a special relationship of trust and confidence. It is such a relationship, DOL asserts, because the recommendation must be individualized to the retirement saver, and made in the saver's best interest. Interestingly, however, these two elements—individualization and a best interest recommendation—are currently required to comply with the non-fiduciary SEC Regulation Best Interest and the non-fiduciary National Association of Insurance Commissioners Best Interest Rule. In other words, to address being told by the 5th Circuit that Congress did not intend sales recommendations to be fiduciary advice, DOL has simply redefined fiduciary to include the required elements of a sales recommendation, casting that as a special relationship of trust.

It is worth noting that many of the proponents of the DOL's Proposals argue that there should be a uniform fiduciary standard applicable to all recommendations to all kinds of retirement savers regardless of what product they buy or what type of financial professional they talk to. They reject the notion that there is a difference between plans and IRAs, and that DOL's two step is both technically legal and an overdue modernization of rules adopted nearly 50 years ago. They argue that the NAIC Best Interest model rule is not strong enough. They argue that the SEC's Regulation Best Interest isn't strong enough. They argue that the world has changed over the past 50 years, that the 401(k) didn't exist when ERISA was passed, and that advice standards for individuals need to change too.

The problem with all of these arguments, however, is that they run headlong into the reality that this is not the system Congress created and that this Committee oversees. To make the changes DOL and proponents of the Proposals envision, they need to effect a legislative, not a regulatory, change. Or as the 5th Circuit wrote in vacating the 2016 DOL rule, "Moreover, DOL's principal policy concern about the lack of fiduciary safeguards in Title II was present when the statute was enacted, but Congress chose not to require advisers to individual retirement plans to bear the duties of loyalty and prudence required of Title I ERISA plan fiduciaries. That times have changed, the financial market has become more complex, and IRA accounts have assumed enormous importance are arguments for Congress to make adjustments in the law, or for other appropriate federal or state regulators to act within their authority. A perceived 'need' does not empower DOL to craft *de facto* statutory amendments or to act beyond its expressly defined authority."[5] Since the 2016 Rule was vacated, both state insurance commissioners and the SEC have acted within their authority to improve consumer protections.

Conclusion:

The Proposals are an attempt to achieve a policy outcome that the law does not permit, and if successful, would simply create multiple regulatory regimes applicable to the same financial recommendations, resulting in significant costs and confusion for retirement savers and their financial professionals. The Labor Department was never intended to be the primary regulator of

[5] *Chamber* at 378-379.

financial professionals except in the specific context of employer-provided benefit plans under Title I of ERISA.

Thank you for this opportunity, and I look forward to answering your questions.