AMERICAN RETIREMENT ASSOCIATION
Working for America's Retirement

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Testimony of
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on behalf of the
American Retirement Association

U.S Department of Labor, Employee Benefits Security Administration Hearing on

Definition of the Term "Fiduciary"; Conflict of Interest Rule-Retirement Investment Advice and Related Prohibited Transaction Exemptions

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Introduction

Thank you for the opportunity to testify today on this important subject. My name is Marcy Supovitz. I am a Principal of Boulay Donnelly & Supovitz Consulting Group, Inc. in Worcester, Massachusetts. We provide consulting, administrative, actuarial and investment advisory services to employer-sponsored retirement plans.

I am speaking today on behalf of the American Retirement Association and its four member organizations: the American Society of Pension Professionals & Actuaries (ASPPA), the ASPPA College of Pension Actuaries, the National Association of Plan Advisors, and the National Tax-deferred Savings Association. I currently serve as President-elect of the American Retirement Association and was a past president of the National Association of Plan Advisors.

Our members are in the business of serving employer-sponsored retirement plans, and are long accustomed to operating under ERISA fiduciary standards and unconflicted compensation structures. These concepts are very much a part of our fabric. Yet there are some disconnects in the proposed rule that would undermine our ability to serve clients in the best way possible.

It's our hope and belief that we can get to a rule that's both more workable and more beneficial for the people it's designed to help. To that end, my testimony today will focus on five key concerns.

Rollovers

The first relates to rollovers in connection with the workplace retirement plans we serve.

Our concern is that the proposed rule will discourage plan advisers from working with participants on rollovers, even in situations where the adviser is receiving level compensation on both sides of the transaction.

That's because a rollover from an employer-sponsored plan to an IRA will likely increase the advisor's compensation if the participant wants personalized, holistic IRA advisory services. And any increase in compensation would be a prohibited transaction, unless an exemption applies. As I'll talk about in a minute, it isn't clear that any such exemption exists.

First, let me give you a specific example of why this rollover concern is important.

> Suppose a 401(k) participant, let's call him Joe, has been working with Plan Adviser A for over 10 years. Like many working Americans, the only adviser Joe works with is Adviser A, through his 401(k) plan at work. Now Joe is about to retire, and the plan doesn't offer systematic withdrawals, which is a very common scenario. So Joe wants to work with Adviser A on a rollover because he trusts her and because the plan doesn't offer him an effective way to manage his money in retirement.
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> The adviser, let's call her Sue, operates as an ERISA fiduciary to the plan and receives level compensation of 30 basis points for those services. She is proposing level compensation of 75 basis points on the rollover IRA because Joe wants personalized financial advisory services. Since both arrangements will be conflict-free, no exemption is required for Sue's work with the plan and no exemption will be required for her work with the IRA, but an exemption is needed for the rollover transaction itself.

It isn't clear that the Best Interest Contract Exemption (BICE) is available for rollover transactions, but assuming it is, it still would not be available for *this* rollover transaction because the BICE doesn't extend to discretionary investment management. Moreover, the BICE is specifically designed for differential compensation. When compensation is level and investment-neutral, it doesn't make sense to impose all of the BICE requirements. That will discourage trusted plan advisers, who have been vetted by the plan sponsor, from serving participants after retirement.

A better solution would be to create a separate, streamlined exemption that I'll refer to as the **"level-to-level compensation exemption."** In order to use this new exemption, the adviser would have to meet some core conditions, including:

- level compensation on both sides of the transaction;
- a written agreement between the adviser and the participant prior to *effecting* (not discussing) the rollover transaction;
- a disclosure that includes a comparison of the adviser's compensation at the plan level and the IRA level; and
- documentation outlining why the rollover transaction is in the best interest of the participant.

For purposes of this exemption, level compensation means that, regardless of the investments selected, there's no change in the *adviser's* compensation. Even if the financial institution as a whole receives differential compensation, there should be no incentive for the adviser's advice to be influenced by any compensation flowing to the financial institution. This approach is consistent with the statutory exemption for "eligible investment advice arrangements" in ERISA sections 408(b)(14) and 408(g).

We believe that this streamlined exemption for level compensation situations would encourage plan advisers to continue to work with participants on rollovers, and would allow participants to maintain their trusted relationships with advisers.

Investment Education Carve-Out

Our second concern relates to investment education. And I want to emphasize that my comments here relate solely to 401(k) and similar workplace plans, not IRAs.

I know that many of those testifying as well as many comment letters have suggested that the proposed rule unnecessarily changes the framework of Interpretive Bulletin 96-1 by prohibiting reference to specific investment products in asset allocation models. I also understand the Department's concern that identifying specific products could be advice disguised as education.

But the issues and implications for workplace plans are very different than for retail-type accounts. In the context of 401(k) plans, asset allocation models are most often designed by the fiduciaries of the plan and then presented by non-fiduciaries to educate participants.

We believe that, as long as the models are populated by ERISA plan fiduciaries that have no financial incentive to choose one investment product over another, anybody should be able to present those models to participants without being treated as a fiduciary.

Research shows that connecting the dots from asset classes to specific funds is critical for participants, especially those who aren't inclined or experienced enough to truly analyze the plan's investment options. For example, a participant may be told that an asset allocation model should include a large-cap stock fund, but she may not know that a high-dividend stock fund is generally less volatile than a momentum-oriented stock fund. Many participants instinctively choose funds based on historical returns alone.

Those participants would be better served by providing them with pre-defined asset allocation models, wherein plan fiduciaries use a rigorous and prudent process to select appropriate funds for each asset class based on the models' risk/return objectives. Once the models are populated, merely presenting them to participants without rendering any investment advice shouldn't give rise to fiduciary status.

We believe this approach honors the regulation's intent while also fostering sound investment decisions and avoiding unnecessary complexity for working Americans.

Small Business Retirement Plans

Our third concern relates to small business retirement plans. It's no secret that small business owners are slow to embrace retirement plans, and without an adviser's encouragement and assistance, many wouldn't adopt a plan at all.

Yet, the proposed rule puts impediments in the way of advisers who want to work with small businesses. Many advisers that service small plans are reliant on the compensation models that would become unavailable under the proposed rule. The final rule should implement the best interest standard in a way that doesn't discourage them from working in this market.

To that end, we suggest expanding the definition of "retirement investor" in the BICE to include small, participant-directed plans. We believe this change is key to preserving the diverse services available to the small plan marketplace.

We also suggest revising the BICE to reflect the fact that ERISA-covered plans are already subject to robust disclosure requirements and enforcement protocols. Thus, the BICE's significant contractual obligations and disclosure requirements aren't necessary and shouldn't apply to ERISA-covered plans.

Platform Carve-Out

Our fourth concern relates to platforms. The proposed rule provides an important carve-out for providers of a platform of investments, from which the plan fiduciary can select specific investments for the plan's menu. The carve-out allows platform *providers* to market their platforms, but in the real world, those platforms are often marketed by third parties, not directly by the provider.

For example, plan fiduciaries often ask third party administrators and advisers to recommend 401(k) record keepers that may present an investment platform to a plan sponsor. It is not clear that these third parties, if not otherwise fiduciaries, are also covered by the carve-out.

We suggest modifying the term "platform provider" within the carve-out to include not only a provider, but an intermediary facilitating the involvement of a platform provider, whether a third party administrator, adviser, or other service provider so long as the intermediary reasonably believes the actual provider will satisfy the platform carve-out requirements.

In addition, the carve-out should be expanded to apply to IRA platforms that meet specified conditions. For example, an IRA provider should be able to qualify for the carve-out by offering an "open architecture" platform or a platform with no proprietary investments, as well as a platform blessed by a third party fiduciary.

Transition Rule

The final but very important concern that I'll discuss today relates to the transition period for implementing the Proposal. Eight months simply isn't enough.

The American Retirement Association estimates that advisors have more than 400,000 existing qualified plan arrangements that will need to be amended to accommodate the final rule. I can tell you with certainty that eight months isn't enough time to accomplish all the due diligence, plan re-design, and communications that will be necessary. We strongly recommend at least a two-year transition period after publication of the final rule. In addition, as part of the transition relief, any prohibited transaction that may occur due to an adviser moving from a current fee structure to a level fee structure or to a structure that complies with the BICE should be deemed an exempt prohibited transaction during the transition period.

Conclusion

The American Retirement Association appreciates the opportunity to work with the Department of Labor on these issues of great importance to our diverse membership. I've summarized our key concerns today. More detail can be found in the comment letter we filed on July 20th. Thank you and I'd be pleased to take any questions.