Testimony of Melanie Franco Nussdorf

on behalf of

The Securities Industry and Financial Markets Association

before

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Good Morning, Chairman Andrews, Congressman Kline and Members of the Subcommittee. I am Melanie Franco Nussdorf, a partner at Steptoe & Johnson, LLP, practicing in the employee benefits area and counsel to, and testifying on behalf of the Securities Industry and Financial Markets Association ("SIFMA"). SIFMA brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

We appreciate the opportunity to testify today on investment advice for retirement savings. Prior to the enactment of the PPA, policymakers consistently cited the need for more professional advice for participants with respect to their retirement savings. There is arguably an even greater need for such advice today, in light of the volatility and precipitous drop in the markets. Only a small percentage of American workers have the benefit of professional investment advice from individuals who hold themselves out to be fiduciaries and subject themselves to ERISA's fiduciary requirements. Current market conditions have affected retirement security and employees' confidence in their financial ability to retire. Our member firms hear everyday that benefit plan clients would like additional advice and support on retirement planning, investment allocation and strategies for these assets. Without additional professional advice in the market place, this situation will not change.

American workers' retirement savings are increasingly held in participant-directed accounts such as 401(k) plans and in IRAs, either by contribution or through rollovers from employer sponsored retirement plans. Today, about 63 percent of the full time workforce is covered by a 401(k) plan; over the next 10 years, a high percentage of these assets will be rolled over into IRAs. IRA assets totaled $4.13 trillion as of September 30, 2008 – they already exceed assets in defined contribution plans, and are expected to increase further as workers retire in greater numbers and roll over their 401(k) balances. As a larger and larger percentage of these savings accumulate in IRAs which may be invested in the entire range of investment products -- annuities, stocks, bonds, foreign investments, mutual funds and other pooled vehicles, investment advice is even more critical to help retirees through this wide array of investment choices.

It might be helpful to provide some context. ERISA and the Internal Revenue Code define every person who provides services to a plan as a so-called party in interest. As parties in interest, service providers are prohibited from engaging in any transaction or providing any service to a plan or an IRA unless the terms of an exemption are met. Prior to the PPA, the exemptions available to fiduciary service providers were limited to a single investment product, such as bank deposits, or mutual funds, or annuities. There was no single exemption that would allow investment advisory services to be provided by someone whose affiliates might be selling investment products, like securities, or mutual funds, or insurance contracts, or bank investment products, to a plan or an IRA unless the advisor recommended none of its affiliates' products. In 1975, Congress thought such a restriction was unrealistic; it is no more realistic now. In 2006, Congress found that the absence of a comprehensive investment advice exemption was largely responsible for the few broad investment advice programs offered by banks, insurance companies and

broker-dealers. Instead, prior to the PPA, a patchwork of exemptions permit a fiduciary to provide advice on one or another product type and then sell that product. Each such exemption contains different requirements and each covers only one type of product. These exemptions often do not contemplate the various compensation arrangements in existence today. In addition, this approach discourages the introduction of innovative products designed to address longevity, inflation and market risks.

There are two problems with this patchwork approach. First, the existing exemptions do not cover many investment products or combinations of investment products that are common today. Second, without a comprehensive exemption covering all types of investments, a fiduciary advisor might be able to provide advice on stocks and bonds held in an IRA, and then act as agent in selling them to a plan or IRA, but that commission arrangement would not permit the advisor to sell affiliated mutual funds. Thus, the advice available from a large financial institution was necessarily limited. What was needed in 2006 was a comprehensive exemption that clearly lays out the requirements for advisors to provide advice to plan participants regardless of what types of investments are being recommended. The PPA addressed that need.

Congress enacted a statutory exemption in 2006 for participant directed defined contribution plans, and directed the Department of Labor to issue a separate class exemption with respect to IRAs if it found that there are no computer models capable of taking into account the full range of investment products available to IRAs.

While we recognize the utility of the current advice programs provided by independent advice providers like Financial Engines and Guided Choice, who are not affiliated with banks, broker dealers or investment companies, no exemption would have been necessary to allow these advisors to provide advice. But current advice programs

do not reach enough workers in ways that are comfortable for those workers, to make professional investment advice the norm, rather than the exception. This was Congress' concern in 2006, and there has been no significant increase in fiduciary advice programs since then. The Department's regulation and class exemption would be a step closer to reaching the stated goal of the PPA's investment advice provisions.

Many advice providers depend on the Internet for the delivery of advice; while that approach may work for some participants, in our experience, plan participants seek personal interaction with their fiduciary advisor. If the rules promulgated under the PPA are allowed to take effect, plan participants will have access to advice providers who offer advice on a wide variety of investments – in person or on the phone – in a cost-effective manner. We think it is critical and beyond argument that we need to increase savings and encourage better investment decisions. We respectfully submit that professional investment advice is a critical step, and unless the ranks of fiduciary advisors multiplies greatly, it is unlikely that there will be any increase in the provision of advice to participants and IRA owners.

Comments received by the Department from individual participants and beneficiaries make clear their need for investment advice, particularly in this economy. If the current unaffiliated advice providers were satisfying that need, those comments would be unlikely. Nothing in the PPA, the Department's regulations under the statutory exemption, or the Department's class exemption would deny participants advice from unaffiliated advisors. Indeed, the Department's rules make clear that every participant must be told that he or she may receive advice from an advisor who is not affiliated with any product. This reminder serves to underscore the choices available to participants and to provide a useful alternative for those who would prefer a different course. But to limit

advice to providers who have no affiliates selling products to plans and IRAs will continue the status quo – not enough advisors, not enough professional fiduciary advice.

There are more than a hundred thousand financial advisors who could and would fill this gap. So why don't they? Prior to the PPA's enactment, we think the answer was pretty clear. Under the Department of Labor's exemptions and interpretations, advisors needed to charge an outside fee from which was offset all fees from the products sold, like internal advisory fees in affiliated mutual funds and commissions from unaffiliated mutual funds. Fixed income instruments, including Treasury bonds, couldn't be sold to the plan or IRA by the fiduciary advisor at all. Often, that offset resulted in a situation where the advisor's fee was fully offset, and hugely expensive systems needed to be created to affect the accounting for the offsets. In addition, these interpretations worked best in an advisory wrap program which the SEC has criticized for buy and hold investors. Also, because of the cost associated with a wrap fee product, most financial services companies only offer this type of program to clients with large accounts – for instance more than $50,000. The PPA advice exemption is crucial to ensure that 401(k) participants and IRA owners who have small balances or who are buy and hold investors are able to get personal advice tailored to their individual goals from commission-based advisors.

The Department has issued the regulations and the class exemption called for in the statute. It provides a special rule for advice offered to a 401(k) plan participant investing through a self-directed brokerage account or to an IRA account holder where modeling is not feasible. This provision recognizes that, as millions of workers move into retirement, they may seek to choose from the many different types of investment products that cannot be modeled effectively with a computer program. IRAs may invest

in stocks, bonds, CDs, currency, annuities, and many other financial products. As more of the population nears retirement, employers and financial services firms are working on product innovations that it may or may not be feasible to model. Reliance on computer models that include only one kind of investment product will stifle innovation or leave middle-income families with few choices in retirement. IRA owners are increasingly interested in investments that can't be modeled, such as bank products, securities (including Treasury instruments), annuities and pooled funds. Let me give just one example: without this class exemption, an advisor could not recommend that an IRA owner invest half his IRA in a product that provides level income for life, and the other half in a laddered Treasury bond program, because there is no model that encompasses both of these products. Nonetheless, this is certainly a program that many IRA owners might reasonably want to consider.

In addition, without the class exemption, a computer model provider could not respond to questions from participants that go beyond the model's required inputs, such as questions about suitable levels of risk. If the results of the model were unsatisfactory, a participant's only choice would be to run the model again, trying to guess at the inputs that would allow the model to provide choices that meet his or her needs. The class exemption addresses how off-model advice can be provided with sufficient safeguards, including contemporaneous recordkeeping, advance disclosure, and audit requirements that will protect participants and beneficiaries and create a record for ensuring that the requirements of the exemption and ERISA's fiduciary responsibility provisions have been satisfied.

The final rule and class exemption protect participants. Only individuals subject to oversight of insurance regulators, the SEC, or similar state agencies or banking

regulators can provide advice. This adds a layer of oversight and protection to these rules that does not exist under current law, where anyone can provide advice so long as he or she follows one of the methods in the Department's existing guidance. Additional protection is found in the requirement that participants be told that they are always free to seek advice on their own from an advisor whose company does not sponsor investment products, if that is what they prefer. This information will cause all plan participants and IRA owners to focus on how much oversight, and indeed skepticism, they want to exercise with respect to their own retirement savings. Another safeguard is the requirement that if an advisor recommends an investment with higher fees, he must explain why the higher fee investment is better for the participant. The material conflicts in the advisor's advice must be fully disclosed in writing: this focused disclosure is still another protection for participants and IRA owners. A further protection is the dire consequence of failing to meet the requirements of the exemption. Not only will the transactions that failed to meet the statutory requirements have to be reversed and the client restored to the position he or she would have occupied had the investment not been made, but unlike any other exemption the Department has issued, if there is a pattern and practice of failures, all of the transactions during the period of noncompliance will lose the relief provided by the exemption and will have to be reversed, *including those that did not violate the law.*

Still another protection is the annual audit. The final regulation and class exemption require the fiduciary advisor to obtain an independent audit on an annual basis. This audit is protective of plan participants and consistent with other exemptions that the Department has granted in the past. The audit requirement is analogous to the so-called QPAM look alike exemptions and the in-house manager exemption which require

an independent annual audit based on sampling. The audit will be done by professionals; the selection of the auditor will be subject to ERISA's fiduciary standards; and the results of the audit will be made available to plan sponsors, IRA owners, and, where there is evidence of a failure to meet the exemption, to the Department. We believe this requirement is a strong protection for participants and beneficiaries which makes the exemption administrable by focusing the Department on the situations where independent auditors found evidence of noncompliance.

The final regulations interpreting the statutory exemption and the class exemption have been subject to a thorough process of evaluation and analysis. The Department issued a Request for Information soliciting public comment before it even began to draft regulations, held two hearings, issued a Field Assistance Bulletin with its views in early 2007, and published a proposed and final regulation and class exemption, as well as a request for comments after the regulation and class exemption had been published in final form. All stakeholders have been heard. While some may disagree with the investment advice exemption in the statute, or with Congress' mandate to the Department to determine whether models exist that can appropriately model any investment in which an IRA may invest, the final regulation and class exemption are both true to the statute and the class exemption contains the statutory findings necessary for the Department to exercise its administrative discretion to promulgate relief. This process has been careful, thoughtful, and designed to elicit the views of the entire benefits community.

The final exemption is clear, protective and administrable. Its disclosure requirements are based on, but more extensive than the basic ERISA exemptions that have been in place for more than 20 years, including PTE 77-4 for a fiduciary's use of its

affiliated mutual funds, and PTE 86-128 for a fiduciary's use of its affiliated broker-dealer. In addition, unlike these earlier exemptions, the advice exemption provides an audit to the plan participant (similar to certain individual exemptions granted by the Department in recent years), and has a far more dire consequence for a pattern of noncompliance. Thus, the advice exemption, by analogy, has been proved to be administrable over time. But what is most important, these rules will, for the first time, present the realistic chance that widespread, easily accessible, person to person based professional fiduciary advice will be available and used by tens of millions of plan participants and IRA owners. We urge you not to lose sight of this goal. If professional fiduciary advice is to become the norm, we need to encourage those that are capable, trained and regulated to step forward and give this advice in a manner that makes economic sense for their employers. If we fail to do that, we may be consigning millions of Americans to "do it yourself" retirement planning.

We thank you for this opportunity to testify and I'd be happy to answer any questions you may have.