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To: EBSA, E-ORI - EBSA
Subject: Investment Advice Final Rule

Ladies and Gentlemen:

My name is David Kudla. I am CEO of Mainstay Capital Management, LLC. I participated in a Wall Street Journal panel discussion on this topic and was invited to debate the subject on CNBC. I would be glad to elaborate further on my comments below and offer testimony on this subject. I can also provide specific examples of how conflicted advice will most certainly be provided to 401(k) participants if the current version of the rule is allowed to stand.

One goal of the Pension Protection Act (PPA) was to facilitate easier access to 401(k) investment advice. This provision of the PPA essentially created an exemption from the prohibited transaction provisions of ERISA (the Employee Retirement Income Security Act of 1974) and the Internal Revenue Code.

In an effort to provide easier access to investment advice legislators penned into law inherent conflicts of interest in that advice. Fee-only, independent, third party advisors were providing 401(k) investment advice on a discretionary basis long before the PPA. Because their compensation was never driven by the investments they were recommending, they never ran afoul of ERISA. Unfortunately, what the PPA has done is open the door to potentially conflicted advice for plan participants, thus eliminating the protections ERISA had in place, which have protected 401(k) participants since the inception of these plans.

One provision of the PPA requires that advice be based on a computer model. But, who is allowed to pay the provider of the computer model? Who certifies the model is unbiased? Who is allowed to pay the certifier? Is the model allowed to use proprietary funds in the plan? If not, does it then provide a non-conflicted, but sub-optimal recommendation? Who monitors all of this on a continuing basis? Hopefully, not the same people at these firms that made sure there was a Chinese wall between the investment-banking arm and stock-rating arm of the brokers in the late 1990's. As a result, $1.4 billion in fines were levied against various brokerage firms because of conflicts of interest in stock recommendations.

A mutual fund or insurance company providing investment advice for participants within a 401(k) plan they administer, that may even have that company's proprietary products as investment options in the plan, is very problematic. How can that not present a potential conflict of interest? Relying on disclosure of conflicts to participants as protection against them is a naive safeguard at best. Just because someone discloses to you that they are stealing your wallet, doesn't make it O.K. And unfortunately, the track record for the financial securities industry to do wrong in an environment that does not offer enough

protection to investors is very troubling. Whether it's B-class share abuses, not honoring breakpoints on A-class shares, market timing, annuity sales practices; the list goes on.

Some have even argued that potentially conflicted advice is better than no advice at all. This demonstrates the traditional "fallacy in a false point". The notion that conflicted advice is "better than no advice at all" is reminiscent of the original 401(k) advice debate between the Boehner bill in the House and the Grassley bill in the Senate. It presumes there is no better alternative. Conflicted or tainted advice should not be the price participants pay to get more advice.

In fact, customized, conflict-free, advice can be delivered to a very large number of employees in an effective and thorough manner. Many independent, fee-only advisors already have years of experience providing advice to meet the needs of the individual 401(k) participant. Since they have no formal ties to the plan sponsor, they are oriented to work in the best interests of their clients and not in the best interests of a financial institution. Senator Grassley tried to preserve this principle (and provision of the 2001 DOL ruling) in his bill. Unfortunately, lobbyists for the securities industry prevailed, and we ended up with a conflicted approach to 401(k) advice within the PPA.

Many corporate benefits administrators recognize the importance of independent, conflict-free advice. My firm provides 401(k) educational programs for a number of companies and other organizations. A Director of Pensions and Benefits at one of the largest companies in the U.S. once said to me, "PPA or not, our 401(k) plan administrator will never be allowed to provide investment advice to plan participants. It is clearly a conflict of interest".

After more than two decades of 401(k) investing, the first piece of legislation addressing 401(k) advice should have done better than provide for cookie-cutter, potentially conflicted advice. The 2001 DOL ruling allowing plan sponsors to provide third party, independent advice was a step in the right direction. The PPA actually compromises the protection against conflicted advice in the DOL ruling of 2001 and compromises the protection ERISA had provided for years.

The fund companies, insurance companies, and others who stood to benefit from being allowed to provide investment advice in these plans, lobbied hard for the Boehner version of the bill to prevail. (Senator Grassley's version of the bill, required third-party independent advice, consistent with the 2001 DOL ruling.) After that long fight, I am sure they will take full advantage of this new marketing opportunity to cross-sell and offer advice on other investments. The opportunity for additional revenue streams for these plan sponsors is just too great to pass up. And, I don't think consumers will understand that plan sponsors may no longer be legally required to act in their best interest once they go beyond giving them advice on their qualified plan and are making recommendations on other investments outside the plan. For instance, brokerage firms do not have the fiduciary responsibility to act in the client's best interest, as Registered Investment Advisors do.

Of course, one could say that my stand on this subject is self-serving because I am an independent, fee-only RIA that provides 401(k) advice to clients. However, there are RIAs that administer 401(k) plans who stand to lose based on my position since they would be restricted in how they could offer advice to participants in plans they administer.

In the end, it is not about whom in the financial services industry wins or loses. It is about right and wrong. It is about making sure participants receive conflict-free advice. It is about making sure that any rule that changes the provisions of ERISA and the DOL ruling of 2001, does not compromise the safeguards against conflicted 401(k) advice that have been upheld for decades.

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Arguing Over Advice

A new law lets sellers of 401(k) funds provide guidance to investors. And that's raising all sorts of concerns.

BY DAISY MAXEY

Across the U.S., workers have been grappling with an assignment handed to them by their bosses with little if any instruction: investment management.

As more companies eliminate or scale back traditional pension plans, many have been unwilling to teach employees how to take on the task of running their own retirement accounts, scared of liability for potentially bad advice. And studies show that individuals generally do a poor job managing their 401(k)s. But help is on the way: The Pension Protection Act of 2006 gives employers a green light to provide extensive guidance to workers.

The changes, which some companies are putting in place now, are expected to increase the range of investment advice available to 401(k) participants. The advice must be offered through a "fiduciary" arrangement, in which fees and commissions wouldn't vary depending on the investment choice, thus removing an incentive for the adviser to peddle funds that pay bigger commissions. It also could be provided through a computer model that has been certified and audited by an independent third party. A fiduciary relationship means that the adviser must consider the investor's interests first and foremost.

So can workers breathe a big sigh of relief? Not so fast. It turns out that many financial advisers and other investment professionals say the new approach may give rise to conflicts of interest, including instances where a mutual-fund or insurance company might provide advice to participants in plans where its own products are investment options. The Department of Labor has offered "interpretive" guidance on the changes and is working on regulations for how the provisions will be put into practice, which it plans to propose in the next several months.

We asked two experts to debate the pros and cons of the Pension Protection Act. Although Nicholas A. Nicolette, president of the Financial Planning Association, which represents independent broker-dealers and registered investment advisers, has concerns about the legislation, he does see a lot of positive attributes. So he took the "pro" position. David Kudla, chief investment strategist at Mainstay Capital, a Grand Blanc, Mich., financial-advisory firm, took the other side.

Here are edited excerpts from their conversation:

BENEFITS AND RISKS

THE WALL STREET JOURNAL: No one disputes that 401(k) investors generally aren't saving enough and could use more advice. How well does the PPA fill this void?

MR. NICOLETTE: There is an advice "gap" that needs to be closed, and as quickly as possible. The Pension Protection Act could help close that gap over time in a number of important ways, and it's critical that the new fiduciary-adviser provision truly works to the benefit of the 401(k) investor, and not the advisory firm.

MR. KUDLA: Access to investment advice for the employee's 401(k) has only grown in importance.

The PPA encourages investment advice for participants by creating an exemption from [certain parts] of Erisa [the Employee Retirement Income Security Act of 1974] and the Internal Revenue Code that have been perceived by some people as an impediment to providing such advice. The rules within the PPA to accomplish this are as elaborate as they are ambiguous. Additionally, in an effort to provide easier access to investment advice, legislators have penned into law inherent conflicts of interest in that advice.

My point is this: Fee-only, independent, third-party advisers have been providing 401(k) investment advice on a discretionary basis long before the PPA. Because their compensation was never driven by the investments they were recommending, they never ran afoul of Erisa. Unfortunately, what the PPA has done is open the door to potentially conflicted advice for plan participants, thus eliminating the protections Erisa had put in place.

MR. NICOLETTE: I agree with David that there are added risks, now that the whole financial-services industry is being allowed to give customized advice. The Financial Planning Association did not embrace this concept. We supported an alternative provision limiting the advice to registered investment advisers, but we're willing to see if the last-minute changes by Congress will serve to protect the public. For example, the changes are designed to reduce the conflicts involved in selling proprietary funds, which means an adviser who works for ABC funds would not have an incentive to recommend ABC funds that are more profitable to the firm, but not in the best interest of the client.

The protections envisioned by Congress require disclosure of these conflicts to workers and payment of level fees to the adviser, so that the employee is alert to the conflicts and the incentives to push less suitable investments by the adviser are removed. In addition, the firm offering investment advice has to keep in mind its potential liability for acting in a fiduciary capacity.

The best way to reduce this risk is through clear disclosure of the conflicts to plan participants, not simply by handing them a piece of paper listing the conflicts. Secondly, in order for the many thousands of insurance and stock brokers to become true fiduciaries to their clients, conflicted firms should train

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their captive agents on what it means to represent the client and not just the firm or themselves.

All of this starts at the top. Senior management should look not only at the marketing opportunities presented by the safe harbor granted by Congress, but the top brass should also be held accountable for any systemic problems that surface.

Congress failed to address one key problem in the act, and that is the absence of any disclosure requirement for a fiduciary adviser who wants to sell investment or insurance products to employees in addition to giving them 401(k) advice. I don't think consumers will understand that their adviser may no longer be legally required to act in their best interest once they stop giving them advice on their qualified plan.

MR. KUDLA: The PPA provision requiring that advice be based on a computer model all sounds good. But who pays the provider of the computer model and who certifies the model is unbiased? Who monitors all of this on a continuing basis? Hopefully, not the same people that made sure there was a Chinese wall between the investment-banking arm and stock-rating arm of the [Wall Street securities] brokers in the late 1990s. As a result, $1.4 billion in fines were levied against various brokerage firms because of conflicts of interest in stock recommendations [stemming from financial incentives that Wall Street analysts had to give positive ratings to stocks of their firms' investment-banking clients].

A mutual-fund or insurance company providing investment advice for participants within a 401(k) plan they administer -- that may even have that company's proprietary products as investment options in the plan -- is very problematic. How can that not present a potential conflict of interest? Under the Pension Protection Act, such an arrangement may exist.

Relying on disclosure of conflicts to participants as protection against them is a naive safeguard. Just because someone discloses to you that they are stealing your wallet doesn't make it OK.

QUALITY, NOT QUANTITY

WSJ: How will such ambiguities affect the willingness of fund companies to provide advice under terms of this act?

MR. NICOLETTE: I don't think this will deter many insurance or mutual-fund companies from stepping forward and offering advice.

The most important question in my view from a quality-of-advice perspective is, can you give customized advice to a large number of employees, get a modest return for your effort, and still do a thorough job?

On the other hand, even if some of it is cookie-cutter advice -- as long as it is unbiased -- it is better than no advice at all. Most 401(k) studies show that workers...tend to be risk-averse, yet they sometimes do just the opposite, taking on inflation risk by putting their contributions in money-market funds, or market risk, by keeping too much of their money in a single company stock. By generally requiring advisers and computer programs to recommend diversified investments, the plan participants will be better off than they were before.

MR. KUDLA: The notion that so-called cookie-cutter advice, or potentially conflicted advice, is "better than no advice at all"...presumes there is no better alternative. In fact, customized advice can be delivered to a very large number of employees and it can and should be done in a thorough manner [by independent, fee-only advisers]. Since they have no formal ties to the plan sponsor, they are oriented to work in the best interests of their clients and not in the best interests of a financial institution.

After more than 20 years of 401(k) investing, the first piece of legislation addressing 401(k) advice should do better than provide for cookie-cutter, potentially conflicted advice.

The opportunity for cross-selling and other additional revenue streams for [some] plan sponsors is just too great to pass up. And I agree with Nicholas: I don't think consumers will understand that plan sponsors may no longer be legally required to act in their best interest once they stop giving them advice on their qualified plan.

MAKING IT BETTER

WSJ: What other steps should be taken to enhance savings in 401(k) plans?

MR. NICOLETTE: I see at least two important additions that are needed. One involves the certified computer model. The Labor Department is wrestling with that mandate from Congress and whether it can approve a computer-software program that provides unbiased investment advice in lieu of a human adviser.... I think it can be done [as] we're talking plain-vanilla index and basic asset diversification over a fairly long period of time, and there are already plenty of proven computer programs in the marketplace.

The second step that I would take is enhancing the section of the law that allows companies to automatically deduct contributions from an employee's paycheck, and to step up the increase over time, to 10% from the current ceiling of 6%.

MR. KUDLA: Automatic enrollment, company matching contributions and other initiatives help enhance savings in 401(k) plans. In our experience, however, companies that have gone beyond these measures to educate employees on plan provisions and benefits through seminars, workshops and other methods are among the companies with the highest 401(k) savings rates. Employees will simply be more willing to utilize a plan if they understand it and recognize the long-term benefits.

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