U.S. DEPARTMENT OF LABOR

EMPLOYEE BENEFITS SECURITY ADMINISTRATION

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PROPOSED RULE: :
INVESTMENT ADVICE & CLASS :
EXEMPTION: PARTICIPANTS AND :
BENEFICIARIES :
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U.S. Department of Labor
Francis Perkins Building
200 Constitution Avenue, NW
Room S-3215 A&B
Washington, DC 20210

Tuesday, October 21, 2008

The hearing was convened, pursuant to notice, at 8:05 a.m., DEPUTY ASSISTANT SECRETARY ALAN LEBOWITZ, presiding.

APPEARANCES:

PANEL MEMBERS:

BRADFORD P. CAMPBELL
Assistant Secretary
Employee Benefits Security Administration

ALAN LEBOWITZ
Deputy Assistant Secretary
for Program Operations

BOB DOYLE

FRED WONG

JOE PIACENTINI

TIM HAUSER

BILL TAYLOR

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1 P R O C E E D I N G S

2 **OPENING REMARKS - INTRODUCTION OF PANEL**

3 ASSISTANT SECRETARY CAMPBELL: All right.
4 Good morning, everybody. Let's call to order, I
5 suppose the term is, this administrative hearing on the
6 proposed regulation and proposed class exemption on
7 investment advice that the Department proposed in
8 August.

9 Please pardon my voice. As you can hear, I'm
10 overcoming a cold. So I'll try and be brief, and that
11 way I won't burden you a whole lot longer with my
12 scratchy remarks here.

13 As you all know, there are about 419,000
14 participant-directed individual account plans. These
15 cover about 65 million people. There's about $2.2
16 trillion in assets in these plans. One of the things
17 that Congress and the administration have long agreed
18 on is that Americans in these plans desperately need
19 access to quality professional investment advice so
20 that they can help make informed retirement savings
21 decisions.

22 Following Enron, the administration proposed
23 that Congress adopt the statutory exemption back in
24 2002, because Enron was, I think, one of the cases that
25 highlighted quite significantly the need for such

1 advice, with concerns about investors being overly
2 concentrated in employer stock and making other common
3 investment mistakes that could have significant
4 consequences on people's retirement savings.
5 Following that, Congress, unfortunately, did
6 not pass that proposal at that time, but it was finally
7 included in 2006 in the Pension Protection Act. The
8 proposed regulation and the class exemption that the
9 Department proposed in August is intended to implement
10 the statutory exemption that Congress passed and
11 further explain how investment advice works in the
12 context of ERISA and its protection for workers.
13 I would say that we've had a fairly long
14 history on this. Following the passage of the
15 statutory exemption, we issued two requests for
16 information addressing the questions that we felt we
17 needed to answer as we started looking at these
18 regulations. That information, and the comments we
19 received, were quite helpful to us in preparing the
20 proposals.
21 We also issued a Field Assistance Bulletin in
22 2007, FAB 2007-01, that addressed our interpretation of
23 the fee leveling provisions, because those had already
24 become effective in January of '07, with the statute
25 having passed August of '06. Then, of course, we

1 issued three items in August, as I mentioned already:
2 the NPRM and the class exemption, which are the subject
3 of this hearing, but also a report to Congress required
4 by the statute regarding the feasibility of computer
5 modeling in IRAs.
6 We intend to finish these regulations by the
7 end of this year and we very much appreciate all of you
8 coming here today to offer additional testimony and
9 thoughts, because as I've said many times and in many
10 places, probably to the point where everyone's tired of
11 hearing about it, we highly value the notice and
12 comment process here at the Employee Benefits Security
13 Administration, and not just because it's a requirement
14 of the APA or of ERISA itself, as in the case of this
15 hearing, but because actually it makes us have a better
16 end product.
17 As talented as our staff is, as smart as they
18 are--and in my opinion they are--we do, nonetheless,
19 not get it right always the first time because we are
20 not out there every day practicing in the area. We're
21 not confronting the real issues that are coming up with
22 real people and real plans, and the diversity of plans
23 and opportunities that there are. So, we benefit
24 mightily--and by "we", I mean all of us, all Americans
25 benefit mightily--from this notice and comment process.

1 So with that, thank you all for taking the
2 time to come here this morning and begin to offer some
3 additional thoughts on this issue, because as much
4 comment as we've had, we certainly welcome the
5 opportunity for some more.
6 So with that, let me turn it over to Deputy
7 Assistant Secretary Lebowitz.
8 DEPUTY ASSISTANT SECRETARY LEBOWITZ: Good
9 morning. I am Alan Lebowitz, Deputy Assistant
10 Secretary for Program Operations at the Employee
11 Benefits Security Administration and I will be chairing
12 the hearing today.
13 On August 22, 2008, the Department published a
14 Notice of Proposed Rulemaking to implement the
15 provisions of the new statutory exemption set forth in
16 Sections 408(b)(14) and 408(g) of ERISA, and parallel
17 provisions of the Internal Revenue Code relating to the
18 provisions of investment advice by a fiduciary advisor
19 to participants and beneficiaries in participant-
20 directed individual account plans, and beneficiaries of
21 IRAs in certain similar plans.
22 On August 22, 2008, the Department published
23 in the *Federal Register* a Notice of a Proposed Class
24 Exemption to permit the provision of investment advice
25 to participants and beneficiaries of self-directed

1 individual account plans, such as 401(k) plans and
2 IRAs.
3 The Department proposed a class exemption on
4 its own motion pursuant to Section 408(a) of ERISA and
5 in accordance with the procedures set forth in 29 CFR
6 Part 2570, subpart B.
7 Upon adoption, both the regulation and
8 exemption would affect sponsors, fiduciaries,
9 participants, and beneficiaries of participant-directed
10 individual account plans and IRAs, as well as providers
11 of investment and investment advice-related services to
12 plans.
13 To date, the Department has received 42
14 comments on the proposed regulation and class
15 exemption. The purpose of this hearing is to afford
16 interested persons an opportunity to supplement the
17 Department's record as it works toward the development
18 of final rules.
19 As to the procedures for this hearing, we will
20 follow the agenda that's been prepared and made
21 available. Speakers will be called in the order
22 listed. We ask that each speaker stay within the
23 allotted 10-minute period.
24 To the extent that members of the panel have
25 questions for the speakers, the question-and-answer

1 part of the testimony will not be counted toward the
2 designated time limit. We wish to note that you should
3 read nothing into the way questions may be phrased and
4 should draw no inferences to the Department's views
5 from the questions asked.
6 For purposes of this hearing, please assume
7 that the panel has reviewed your written comments or
8 written statement, if submitted. For this reason, we
9 encourage speakers to summarize their views or the
10 views of their client in their oral testimony.
11 Prior to beginning your testimony, we ask that
12 you identify yourself, your affiliation, and the
13 organization that you represent for purposes of our
14 hearing Reporter who is transcribing this proceeding.
15 For those who wish to supplement the record,
16 the record of this proceeding will be kept open until
17 the close of business Monday, October 27, 2008. The
18 official record of this proceeding will be open for
19 public inspection and copies will be available in the
20 Public Disclosure Room of the Employee Benefits
21 Security Administration in Room N-1513 here at the
22 Labor Department, 200 Constitution Avenue, N.W.,
23 Washington, DC.
24 I will now introduce the other members of the
25 panel. You have already heard from Assistant Secretary

1 Brad Campbell. To his left is Robert Doyle, Director
2 of Regulations and Interpretations in EBSA. To my
3 immediate right is Bill Taylor, counsel for Regulation
4 in the Plan Benefits Security Division in the Office of
5 the Solicitor. To his right is Fred Wong from the
6 Office of Regulations and Interpretations.
7 I will now call the first witness: Louis S.
8 Harvey, president of DALBAR, Incorporated.
9
10
11 **DALBAR, INC.**
12 **By Louis S. Harvey, President**
13 MR. HARVEY: Thank you, gentlemen. I
14 appreciate the opportunity to give testimony here. My
15 name is Louis Harvey. I'm the president of DALBAR,
16 Incorporated. Our business is primarily in the
17 evaluation, and I'd say more recently auditing, of
18 financial institutions and financial services firms,
19 including advisors.
20 In addition to the comments I submitted
21 earlier, there are really four points I wanted to
22 quickly touch on in light of the events of the last
23 month or so, one of which highlights the need for
24 financial advisors, I'd say, even more vividly than did
25 Enron a few years ago.

1 The second, is talking about the value of the
2 proposals from two perspectives: one, is the
3 perspective of the plan sponsor who has to, in the case
4 of employer-sponsored plans, adopt these services;
5 then, secondly, from the perspective of the advisor
6 whose business is engaged in providing these services,
7 both of which need to be considered in terms of the
8 final regulations.
9 Then I will end with a brief comment on
10 identifying competent advisors, which I think is part
11 of the objective of the process. So we see two
12 objectives. One is making advice available to a larger
13 proportion of our pre-retirement and retirement
14 population, but also making sure that those advisors
15 are, in fact, competent.
16 In terms of the need for personal advice, I
17 start off with the notion that investment advice is an
18 imprecise science. It is not formulaic. We keep
19 discovering new things all the time, and therefore we
20 need to keep adapting as we go forward.
21 When you think of what's happened in the last
22 few weeks and you think of participants and
23 beneficiaries watching TV and hearing politicians talk
24 about this being the worst time since the Great
25 Depression, and we hear recommendations coming off the

1 broadcast media about, you should sell all of your
2 stocks because the world is coming to an end. I even
3 saw an Internet YouTube broadcast that talked about the
4 dollar going down to a 10-cent value. Clearly, these
5 participants and beneficiaries, like we all are, are
6 going to react to that. They have an immediate
7 reaction.
8 As a result, they've inundated phone centers,
9 they've inundated the advisors they've talked to, and
10 they've inundated the people who they consider to be
11 experts. They are looking for answers to just one
12 basic question. The one basic question they're trying
13 to answer is: what do I do now? What do I do now? If
14 you carefully consider that question, the answer to it
15 very often in the ERISA environment is a prohibited
16 transaction, depending on who you ask. There is a
17 conflict there. There is clearly a need for the kinds
18 of exemptions that we've been talking about here that
19 permits the professionals in the business to give
20 advice to participants, and not only in these hours of
21 crisis, but in preparation for the next crisis.
22 We see as an important solution here something
23 that the Department has already done, and that is the
24 QDIA is a key factor in that. I think that the data
25 shows that the people who are in these pre-packaged

1 solutions have had less concern, less problems, and
2 more prudent reaction than people who have actually
3 picked their own investments. By the way, I think
4 these pre-packaged solutions--I have mentioned this
5 before--should really apply to both IRAs and the 401(k)
6 world.
7 The other component, clearly, is a competent
8 advisor for those participants and beneficiaries who
9 have more complex problems and more issues than could
10 be solved with the pre-packaged solution. That being
11 said, I think it's vividly clear that there is a need
12 for advice.
13 Let me turn briefly now to the plan sponsor
14 side of the world and address a couple of issues there.
15 I like to think of each of the regulations and the
16 proposals that come through from time to time from the
17 perspective of various users of the kinds of services
18 that are affected. That is why I picked on the plan
19 sponsors first. The question that resounds for me is,
20 what's in this for me? What's in this for me?
21 From a plan sponsor perspective, one has to
22 consider, first of all, we're asking plan sponsors to
23 take on additional fiduciary liability by virtue of the
24 fact that we're asking them to select and monitor
25 fiduciary advisors. So why do I want to take this

1 additional burden on? Why incur the expense? Because
2 it's either the plan sponsor's own expense or the
3 participant's expense, but somebody has to pay for
4 these services.
5 Another concern that I think we've seen,
6 although it's sort of more of an undercurrent, is the
7 fear of violating anti-discrimination regulations, in
8 that the greatest beneficiary of the fiduciary advisors
9 tend to be the highly compensated. This relief, this
10 fiduciary relief that's being offered here, I think is
11 an important element, but it isn't the driver of
12 change. It isn't the thing that makes the plan sponsor
13 stop and hear, I have to get onto this.
14 One of the reasons for that is that there's a
15 level of comfort in the plan sponsor community that
16 they're doing everything right. They're not really at
17 risk, so the fear of repercussions of violating ERISA
18 isn't there because they think they're basically doing
19 the right thing.
20 Additionally, that feeling is supported
21 because there is a bit of a gap between what
22 participants are thinking and wanting and what plan
23 sponsors are thinking and wanting. With the
24 combination of regulations and opinions and
25 interpretive bulletins over the last several years,

1 plan sponsors feel that they are, in fact, providing a
2 sufficient basis for participants to make investment
3 choices within their participant-directed plans.
4 The "however" is, that's not the feeling on
5 the part of the participants. The feeling on the part
6 of the participants is, they are not supported by that.
7 Both points of view, by the way, are supported by lots
8 of data--I don't think I need to quote that here--that
9 plan sponsors feel that they are providing the basis
10 for making these investment choices to the participants
11 and the participants don't quite agree.
12 One suggestion we have here is, in fact, to
13 make the choice of incorporating the fiduciary advisory
14 program within a plan, make it an affirmative choice to
15 not do it--in other words, to explain why you're not
16 using a fiduciary advisory--and make that decision
17 process available to plan participants. Once plan
18 participants understand that there is a vehicle
19 available to them and it's their employer's choice not
20 to use it, I think we can change the dynamic, quite
21 frankly, for the plan sponsor community. So, in
22 essence, what I'm suggesting is to make the fiduciary
23 advice decision a negative election on the part of the
24 plan sponsor.
25 Quickly, looking at it from the perspective of

1 the advisors, we have a different set of dynamics.
2 What's in it for me, from the advisor perspective, is
3 the advisor is now going to have to spend more time in
4 assisting these participants. They're going to have to
5 face additional regulatory steps. They're taking more
6 risk if they assume the fiduciary role, and potentially
7 lower compensation in that world. So why would these
8 advisors want to jump on board? They're going to have
9 to clearly make capital investments in providing these
10 services as well.
11 They also have to consider that a lot of the
12 audience that we're talking about happen to be people
13 who are qualified or probably more properly put into a
14 QDIA-type solution, so why would they be competing with
15 a QDIA? It doesn't really make a lot of economic
16 sense.
17 The thoughts on increasing the interest of
18 advisors in becoming fiduciary advisors have a couple
19 of points. One, is to make an explicit provision that
20 individual participants can pay for the services of the
21 fiduciary advisor. I know where it stands, there are
22 various interpretations because it's not explicit in
23 the PPA or in the regulations that I've read where it
24 is explicit that it says the plan participant -- it is
25 legitimate, if you will, for the plan participant to

1 pay the expenses. We talk about the plan, we don't
2 really talk about the plan participant.
3 The other issue -- time's up? Okay. I guess
4 I will honor the clock. If you have any additional
5 questions, I'd be happy to share them. In fact, I'll
6 probably submit the remainder of the testimony I had in
7 writing.
8 SECRETARY CAMPBELL: If I might follow up on
9 one thing you said. I wasn't quite sure what you meant
10 about a negative election on the part of the plan
11 sponsor. Are you suggesting that the regulation should
12 essentially require investment advice unless a sponsor
13 affirmatively determines that it's not appropriate?
14 What would be the basis for a provider making the
15 negative election that you've described?
16 MR. HARVEY: The basis for the negative
17 election would be similar, I guess, to the 404(c)-type
18 structure, which says, you know, here are the steps one
19 needs to go through to qualify under 404(c). If we did
20 the same sort of thing within the fiduciary advisor
21 universe, the plan would elect to -- in the case of the
22 plan they would elect not to have a fiduciary advisor,
23 but you would make that, in fact, a fiduciary-type
24 decision, so you'd simply have to document the fact
25 that you have elected not to use a fiduciary advisor.

1 SECRETARY CAMPBELL: Okay.
2 MR. DOYLE: Clearly, one of the cornerstones
3 of protections that both Congress felt was appropriate
4 in this area of potential conflicts, as well as the
5 Department in its proposed class exemption, is the
6 annual audit requirement. I was just curious, since
7 you said you have some experience in that area. I was
8 just wondering whether you could speak to that
9 experience a little bit in terms of perhaps
10 difficulties that you're encountering, successes in
11 identifying potential problems, and that type of thing.
12 MR. HARVEY: Certainly. I would say probably
13 the greatest difficulty we've had in dealing with this
14 has to do with understanding the compensation issue.
15 We have only been auditing -- well, clearly we've only
16 been auditing level fee fiduciary advisors to date
17 subject to the proposal we have now. But it's trying
18 to understand the limits and the parameters of the
19 level fee arrangement.
20 As I see it, frankly, there are good advisors
21 and there are advisors that are, perhaps, not so good.
22 Trying to separate those two on the basis of how they
23 get compensated is an extremely difficult proposition.
24 The thought here is that if one was to establish a
25 trust, a blind trust into which payments are made that

1 separates the advisor from the payment stream so that
2 you don't have that apparent conflict of interest, it
3 might be helpful. But that is clearly the largest
4 issue.
5 The second largest issue is the fiduciary
6 responsibility. The problem there is that institutions
7 have a very difficult time keeping track of who is
8 doing what to whom out in the field. The other aspect
9 of that is that insurance coverages generally available
10 today do not include named fiduciaries. Explicitly,
11 the coverage excludes the named fiduciaries; therefore,
12 once you have signed an eligible investment advice
13 arrangement, by definition you are a named fiduciary on
14 the plan. So I'd say those are the two big issues that
15 we've come across.
16 MR. DOYLE: We have, I think, taken a fairly
17 comprehensive approach in terms of attempting to
18 protect against the influence of compensation in the
19 investment advice area. I mean, are there things that
20 we could do to further tighten that definition?
21 MR. HARVEY: I think the thing we really need
22 to do is to insulate the payment stream from the advice
23 delivery. From a regulatory perspective, it might be
24 very helpful to expressly state that it's okay, if you
25 will, to have a third party collect the fees and then

1 have that third party contract with the advisor, so you
2 have an intermediary in the process. This is a bit
3 different from the offset arrangement, where there
4 isn't a third party, necessarily, but the fees are
5 being rebated back to the plan.
6 I think that's clumsy in this scenario if
7 there was, in fact, a clearing facility into which
8 these compensation schemes are paid and then that party
9 has a contract with the advisor. That's an approach I
10 know that people are taking to this. The core problem
11 is, the best advisors are the ones that we want to be
12 providing this advice. It's very difficult to ask this
13 great advisor to give up compensation in order to do
14 this. You're going to lose the best people if the
15 compensation issue isn't addressed.
16 DEPUTY ASSISTANT SECRETARY LEBOWITZ: Is the
17 problem that it's difficult to determine the source of
18 -- in the audit context, is it that it's difficult to
19 determine the source of the advisor's compensation?
20 MR. HARVEY: No. No. The process that we
21 use, is we ask for the advisor's entire compensation,
22 not only the compensation associated with fiduciary
23 advice. So once you look at -- and that's generally
24 readily available. It's sort of like, can you find
25 your paycheck? That's not the problem. The problem is

1 assessing whether or not the advice can influence that
2 compensation. In other words, can the compensation
3 vary based on the advice? That's the tricky part.
4 MR. DOYLE: So in terms of the audits that
5 you've conducted, have the fiduciary advisors been
6 forthcoming in defining and setting forth what their
7 compensation packages are such that you can evaluate
8 the extent to which those compensation packages reward
9 one for the advice they give, is sufficiently
10 objective, that you can determine that there is not a
11 direct connection or indirect connection between the
12 advice and the compensation? I mean, I would think
13 that would be the starting point to conduct --
14 MR. HARVEY: Yes. I think there are two
15 answers to that question. The first one is, it's very
16 much a self-selection process, meaning that the point
17 of determination is whether or not they want to become
18 a fiduciary advisor and, therefore, comply. Very often
19 they look at the issue and say, gee, you know, I don't
20 think I want to go through the hurdles to comply with
21 this. So that's sort of the first problem, and
22 probably the bigger one. In terms of the people who do
23 decide to go ahead, very often we'll work with them up
24 front to establish a road map as to what makes sense
25 and what meets that regulatory standard and what does

1 not.

2 MR. DOYLE: Because ultimately you will have

3 to certify as to whether or not they had, in fact,

4 complied with that standard.

5 MR. HARVEY: Absolutely. Yes.

6 MR. DOYLE: And their failure to comply with

7 that standard has certain ramifications that are

8 significant.

9 MR. HARVEY: Right. Yes. No, the second step

10 -- well, I guess, keep in mind that many of these folks

11 are coming from a highly regulated environment, so the

12 idea of non-compliance is an anathema to them,

13 especially to the compliance departments and their

14 firms. So they are very careful up front and we have

15 not seen any run on this service at this point.

16 MR. DOYLE: Thank you.

17 DEPUTY ASSISTANT SECRETARY LEBOWITZ: Thank

18 you very much.

19 MR. HARVEY: Thank you very much.

20 Our next witness is Bert M. Carmody, CPA,

21 Director of Consulting for Fiduciary Risk Management.

22

23

24

25

1 **FIDUCIARY RISK MANAGEMENT**

2 **By Bert M. Carmody, CPA, Director of Consulting**

3 MR. CARMODY: Good morning, gentlemen. Thank
4 you for giving us the opportunity to speak and testify
5 on these important regulations. Fiduciary Risk
6 Management is a Title 1 ERISA consulting firm that does
7 fiduciary reviews of organizations. We also serve as
8 litigation support, so when we saw this regulation we
9 were interested in it because there's a lot that goes
10 on here that affects the advice of a plan and fiduciary
11 duties.

12 Overall, with the proposed regulations, we
13 agree with that. We think that this is a step in the
14 right direction. We do have some comments on some
15 things that we need to have clarified, but overall we
16 like the direction of where this is going. We like the
17 idea of having an outside expert review and certify the
18 models.

19 Our question is, from your concept, who would
20 that be? If you could just build me a scenario, we
21 think that it's going to be someone that's probably not
22 going to be related to the advisor. You have in here
23 conversations about material affiliations and we kind
24 of tripped over both of those definitions, because if
25 I've got an outside expert certifying my computer

1 models, who is that outside expert? That's question
2 number one. We'd just like to have that clarified.
3 Likewise on the audit side, in F(i)(3),
4 there's a question about material affiliation for
5 compensation. It's either 5 or 10 percent. From our
6 perspective, anybody certifying a model or anybody
7 auditing the process should have a material affiliation
8 of zero dollars.
9 The whole purpose here is to make that an
10 independent process. That allows fiduciary advisors to
11 say, I've been looked at by someone on the outside.
12 They are independent, they are not related to me in any
13 way. I think that the concept of material affiliation,
14 you've got it in other scenarios here, but for those
15 two scenarios we think that zero is the best answer.
16 You had mentioned in D(1)(iii) or F that the
17 computer models -- or D(2). That's probably the better
18 place. The computer model has been changed and that
19 causes the process to be recertified. I think this is
20 an obvious statement, but I think it's important to
21 say, why are models being changed? I come from an
22 investment environment where the basic principles of
23 this business really have not changed. As the other
24 gentleman suggested from the press and the media,
25 there's a lot of noise about how disastrous this

1 universe is right now.
2 Well, if I remember correctly, we've been
3 through these things before: I think 9/11 was a pretty
4 bad situation, I think the foreign currency meltdown of
5 the late '90s was a bad situation, and I think the
6 original crash in '87 was a bad situation.
7 The whole issue here is, from an investment
8 principle aspect, an advisor really should not be going
9 in there and changing its models dramatically, because
10 to me the whole purpose of changing a model would
11 either be: A) I'm going to try to move this into more
12 revenue enhancing opportunities for me as the advisor;
13 or B) there might be some market change that would
14 cause that, and I would look at that skeptically.
15 If you look at some of the models that are
16 classic in this business, those models really haven't
17 changed. The components inside may because that's part
18 of the investment selection and monitoring process of
19 the advisor with his plan sponsor fiduciary, but I
20 don't see the models changing dramatically.
21 So our question there--again, you have it in
22 here--is that I think it's important for advisors to
23 state the reasons why they're doing this. Again, we
24 look at those kinds of things or we're skeptical about
25 those kind of things.

1 You had mentioned in the *Federal Register* on
2 page 49,898, allowing models to favor particular
3 investment options. Likewise, we look at that with a
4 little bit of skepticism, particularly in the
5 environment now that we have because all of a sudden
6 investment decisions are back into the emotional arena,
7 and that's how people get in trouble.
8 So I think if we have any models that favor
9 particular investments, I'll look at it from two
10 perspectives, and one of these I've mentioned earlier,
11 and that is that we could move investments to someone
12 that very, very nicely compensates above and beyond, or
13 secondly, even more so is a move to have less
14 diversification. There are market timing pieces still
15 out there. Whether you're a market timer or not, I
16 want to make sure that investment models steer away
17 from that process.
18 Our comment on self-directed brokerage, which
19 you had mentioned on page 49,899 in the proposed
20 regulations, J(1), I think you've covered the self-
21 directed brokerage. But I think the other thing is,
22 we're skeptical about self-directed brokerage. I've
23 had to tolerate it when I've advised my clients. I'm
24 certainly not in favor of it because when someone has a
25 self-directed brokerage, they think that they're

1 smarter than everybody else in the universe and they
2 get into trouble. But I think the other thing that has
3 to happen is, if there's any material that encourages
4 someone to use a self-directed brokerage option in this
5 process of advice, I would look upon that with extreme
6 concern.
7 The comments that we've talked about earlier,
8 certainly in the 408(b)(2) conversation, where a
9 provider offering a brokerage window, I think the whole
10 issue about fees and disclosure in this kind of
11 environment become absolutely more important. We've
12 talked about 408(b)(2) earlier this spring from an
13 overall perspective, and now we're starting to fit on
14 applications where that works. I think that there's a
15 careful disclosure here, because brokerage windows are
16 very, very expensive.
17 On the disclosure side, under G(3), there's
18 language in there that talks about disclosing
19 affiliations as a generic. But I think it's also
20 important that this disclosure either be expressed as a
21 dollar amount or a percentage of the total income. One
22 of the things that we have to look at here is making
23 sure that if I've got an affiliation, material or
24 otherwise, 10 percent of a material affiliation to the
25 advisor is a whole lot different than someone paying 60

1 percent of its compensation. Whether it's a dollar or
2 a percent amount, I'd just like to have that tightened
3 up, a bit more quantified, and I think that will be a
4 big help to the process.
5 The other thing I saw in this, and the focus
6 of this proposed regulation, was to deal with the
7 automated computer models. There was this little voice
8 going on in my head saying, what about the non-
9 computerized models? I think that those ought to be
10 looked at very, very carefully as well, because while
11 the computerized models are for everyone that needs
12 that kind of assistance, there are a lot of folks that
13 need non-computerized models, and I'd like to have
14 those under the same kind of scrutiny.
15 Other than that, gentlemen, thank you for the
16 opportunity to speak. I'll be happy to answer any
17 questions.
18 DEPUTY ASSISTANT SECRETARY LEBOWITZ: Thank
19 you.
20 SECRETARY CAMPBELL: Let me follow up on your
21 point about the brokerage windows.
22 MR. CARMODY: Yes.
23 SECRETARY CAMPBELL: So if you have a plan
24 that has a variety of options and a brokerage window,
25 is it your view that the computer model should advise

1 to the exclusion entirely of the brokerage window or --
2 MR. CARMODY: Yes.
3 SECRETARY CAMPBELL: Okay. So it's not your
4 view that it should advise on the options, and then
5 perhaps augment options for missing asset classes or
6 something with the brokerage window, or alternatively
7 give advice on just the options, or advice on just the
8 brokerage window?
9 MR. CARMODY: Well, I think the brokerage
10 window has its own personality in this. I'm hoping
11 that the plan actually has a diversified line-up of
12 investment choices and I would build the model around
13 those.
14 Two areas. Obviously, the brokerage window,
15 and anybody that wants to preserve their holdings in
16 company stock, I think the models have to make sure
17 that there's got to be a fence around that. I think
18 any model that reaches into the self-directed brokerage
19 window does that at their own risk.
20 SECRETARY CAMPBELL: Okay.
21 MR. PIACENTINI: I'd like to pick up a little
22 bit as well on the issue of the brokerage windows.
23 Your comment actually references and says, "we see
24 continued abuse in self-directed brokerage accounts."
25 MR. CARMODY: Yes.

1 MR. PIACENTINI: But it doesn't explain what
2 that is. So I guess my first question is, what is
3 that? Then the follow-up question is, we've heard in
4 other comments that there are some commonalities
5 between brokerage accounts and IRAs, and so does what
6 you say about brokerage accounts have any implications
7 for IRAs?
8 MR. CARMODY: It could, but we've not looked
9 at the IRA situation as closely. My concern about
10 brokerage window, as in any kind of brokerage
11 arrangement, is churning, market timing, the
12 opportunity to move investments back and forth. From a
13 mutual fund perspective, you've got redemption fees out
14 there to slow down short-term trading. You have none
15 of those in a brokerage window. Our concern there is,
16 we're setting up people to fail all by themselves,
17 regardless of how smart they are.
18 MR. PIACENTINI: So the concern then is more
19 the way participants are using brokerage windows than
20 it is the structure itself.
21 MR. CARMODY: Yes. My concern is how
22 brokerage windows are being marketed. To me, a
23 brokerage window gives a subtle suggestion that the
24 investment line of the plan is not sufficient. Now,
25 granted, you're going to have some people that

1 absolutely insist on having a brokerage window. My
2 concern is that quite often these products are heavily
3 marketed, heavily pushed on to plan sponsors. That has
4 to be done with real care.
5 MR. PIACENTINI: Thank you.
6 MR. TAYLOR: When you say "build a fence"
7 around them, what does that mean? Do you mean ignore
8 them entirely or just take them into account but not
9 make any recommendations?
10 MR. CARMODY: No. I would ignore those two
11 types of investments entirely, because to me the whole
12 purpose of the computer models is to hopefully build a
13 set of asset allocation directions for participants,
14 either based on age or based on level of risk.
15 MR. TAYLOR: But should that take into account
16 other assets that the participant has?
17 MR. CARMODY: No. Here's why: because when
18 you look at the asset allocation, what's the whole
19 investment mind-set? That is, let's make sure we
20 diversify into proper areas. So I'll pick on large cap
21 growth as a place to go. If I've got large cap growth,
22 I'd like to have it in a diversified area of large cap
23 growth, not just one or two stocks in that area,
24 because the whole thing here from a model perspective
25 is to provide asset allocation with diversification in

1 the process. I don't want to have things tied up in a
2 single security and have a model point to that.
3 MR. TAYLOR: Well, a point to it, but would it
4 take that into account, your other investments, in
5 deciding how to allocate the designated options?
6 MR. CARMODY: That may go beyond the
7 computerized piece. I think asking the computerized
8 model, you can certainly program a computerized model
9 to ignore those and I think that's probably the first
10 level of conversation. But I think the second level
11 is, you could ask a participant, you've got 25 percent
12 in company stock and you've got a brokerage window
13 where you own 15 percent of other things, it's going to
14 be hard to construct a computerized model to do that,
15 other than ignore it. I think at that point the advice
16 has to change. We have to move away from the
17 computerized models and talk to the real people and do
18 the normal investment planning conversation. Thank you
19 very much.
20 DEPUTY ASSISTANT SECRETARY LEBOWITZ: Thank
21 you.
22 Our next scheduled witness is Damon Silvers,
23 Associate General Counsel of the AFL-CIO.
24 VOICE: Mr. Silvers is on his way here.
25 SECRETARY CAMPBELL: Every now and then the

1 government runs more efficiently than we anticipate.
2 (Laughter)
3 DEPUTY ASSISTANT SECRETARY LEBOWITZ: It
4 certainly surprised me. We will take that into account
5 and when Mr. Silvers arrives, we'll hear from him.
6 VOICE: Thank you very much.
7 DEPUTY ASSISTANT SECRETARY LEBOWITZ: Jon
8 Breyfogle, from the Groom Law Group, and Michael
9 Hadley, Associate Counsel, Pension Regulation,
10 Investment Company Institute.
11 SECRETARY CAMPBELL: Before the witness begins
12 speaking, I have to leave to give a speech here in a
13 few minutes. So if I leave in the middle of your
14 remarks, please don't be offended. I'll be back after
15 that.
16
17
18 **INVESTMENT COMPANY INSTITUTE**
19 **By Jon W. Breyfogle, Groom Law Group**
20 **By Michael L. Hadley, Associate Counsel,**
21 **Pension Regulation**
22 MR. BREYFOGLE: I, on the other hand,
23 anticipated the efficiency with which this proceeding
24 would proceed. So is it 10 minutes for remarks?
25 DEPUTY ASSISTANT SECRETARY LEBOWITZ: Yes.

1 MR. BREYFOGLE: I am Jon Breyfogle. I'm with
2 the Groom Law Group and I'm representing the Investment
3 Company Institute. I'm joined by Mike Hadley, counsel
4 for the Institute. We appreciate the opportunity to be
5 here today. The Institute and its members have a
6 significant interest in the regulation and the class
7 exemption.
8 We are going to focus our remarks primarily on
9 the class exemption. I have prepared some remarks that
10 I'm working from and distributed that we'd like to have
11 included in the record. They supplement the formal
12 comments that we made during the comment period as
13 well.
14 We are, as I mentioned, in support of both the
15 regulation and the class exemption. The need for the
16 exemption and the regulation is clear, in our view.
17 Investment advice is offered to less than half of ERISA
18 plans. This contrasts with the widespread availability
19 of advice and the use of advice outside of the ERISA
20 market, according to the Institute's own data.
21 Advice in these financial tumultuous times, we
22 think, is particularly critical. You mentioned, Brad,
23 at the beginning, the Enron circumstance. But -
24 obviously - having a good, long-term retirement plan,
25 understanding the need for diversification, a long-term

1 view in light of the short-term crisis, those are all
2 things that we think professional investment advice can
3 help address.
4 We think the advice that's available currently
5 is great, advice that's either just educationally
6 based, based on I.B. 96-1, or fee leveling, or computer
7 modeling. All of them are good ways to go, and many of
8 our members do just that. But it's obviously not
9 completing the picture here and we need to pursue every
10 avenue we can to get more advice available in the
11 marketplace.
12 I'm going to focus my comments mainly on the
13 class exemption. As I mentioned, I've read through the
14 comments that have been filed with the government, many
15 of them questioning the need for the class exemption in
16 particular, and the Department's authority to issue it
17 as proposed, which we think there is such authority.
18 So what you have here is our review of the exemption
19 standards and why we think the class exemption fits
20 within the exemption standards.
21 As you all know better than I, [sec.] 408(a)
22 gives you broad authority to issue a class exemption.
23 It has three basic standards: administrative
24 feasibility; in the interest of participants; and
25 protective of participants -- the latter two somewhat

1 overlapping.
2 We think it's very clear that you have the
3 authority to issue this class exemption. First of all,
4 the fact that there's a statutory exemption in no way
5 modified the authority of the Department, under 408(a),
6 to issue an exemption to begin with. You had the
7 authority to issue this exemption before the statutory
8 exemption was prepared, so in no way did the Congress
9 amend 408(a) or amend the general authority the
10 Department has, which is really the source of this
11 effort.
12 A second point is that the class exemption is
13 not at odds with the government's and this Department's
14 prior practices in issuing class exemptions, another
15 comment that was made. There are at least three, if
16 not four, class exemptions that have been in place back
17 to the '70s that cover self-dealing, anti-kickback
18 rules, on a disclosure basis without fee leveling, or
19 offsets, or computer models, or independent
20 fiduciaries.
21 There's never been any finding that any of
22 those exemptions don't work or have been subject to
23 abuse: 75-1, 86-128, 84-24 are three; 77-4 is a partial
24 fee leveling but not a complete fee leveling exemption;
25 86-128 had a disclosure scheme that's the most robust

1 of all those, but it pales in comparison to the one
2 that's proposed here.
3 This class exemption basically harmonizes all
4 of those prior exemptions and makes them work better,
5 so it is just simply not the case that the government
6 or this proposal is at odds with the way the Department
7 has administered, interpreted, and applied the
8 standards of 408(a).
9 The other point I'd like to make is that many
10 commentors said that the statutory exemption must
11 mandate complete fee leveling, and the regulation
12 itself, just interpreting the statutory exemption which
13 only requires fee leveling at the institution and the
14 employee level and not at the affiliate level, somehow
15 is inconsistent with the statute.
16 It just simply can't be the case that
17 Congress, in a statutory exemption, codified the Frost
18 Bank letter, the Country Bank letter. You have to read
19 a statutory exemption to exempt something. It is
20 obviously the case that the Department does not think
21 that fee leveling approaches even require an exemption,
22 and I would agree with that. You eliminate the
23 conflict of interest. You don't have a violation of
24 406(b).
25 So it can't be the case that Congress adopted

1 hundreds of words and pages and pages of exemption text
2 simply to permit something that doesn't violate 406(b)
3 already, so that kind of interpretation of Congress'
4 intent just doesn't make sense to me.
5 It is also incorrect, at least in our view,
6 that the off-model advice provision is inconsistent
7 with the statutory exemption. The statutory exemption
8 clearly contemplates the ability of participants to
9 request additional advice, that that's different than
10 the computer model or that that's different than the
11 fee leveling. What it doesn't say is what's the
12 consequence of that request. Can an advisor who has a
13 relationship with the individual answer the questions
14 that are being posed? The class exemption simply deals
15 with that issue.
16 What I'd like to do is just tick off real
17 quick why we think each of the requirements of 408(a)
18 is met. I may not get to the specific comments we have
19 on the class exemption itself. There are some things
20 that we'd like to see, changes in the class exemption
21 to make it more workable; those are laid out in some
22 detail in our comments. A couple of our key points are
23 summarized at the end of the testimony.
24 First of all, we think the class exemption is
25 administratively feasible. Fiduciary advisors will be

1 able to construct compliance schemes that offer the
2 types of up-front, ongoing, and periodic disclosures
3 mandated. They'll be able to establish audits. These
4 are not minuscule tasks, by the way. If you actually
5 work through them with a financial firm, you're
6 actually trying to figure out how to do it, it is very
7 complex and cumbersome but it can be done.
8 In terms of administrative feasibility, I'd
9 like to make a couple of points. I think that the fee
10 leveling provision, as adopted in the class exemption
11 as well as the off-model advice provision, in fact make
12 the class exemption far more administratively feasible
13 than the statutory exemption. I think that is worth
14 taking into account in considering feasibility.
15 It is incredibly difficult to do the fee
16 leveling at the institution level and individual level,
17 to completely restructure fee arrangements. It is
18 almost unworkable. Moreover, if you permit the
19 disparity in fees at the affiliate level, why does it
20 matter at the parent level? So I think it makes that
21 provision far more workable and it addressed the fee
22 conflict at the point where it matters the most, the
23 individual who actually controls what advice is given.
24 So I think it has a meaningful protective impact, but
25 makes it more workable.

1 On the off-model advice, it's the same basic
2 point. The class exemption makes more feasible and
3 workable a provision in the statutory exemption, which
4 had a big, unanswered question, which is what happens
5 when a participant asks for advice. Do you have to
6 stay mum? Can you give advice? Is it a trap for the
7 unwary that you respond to the questions but you don't
8 have relief? So I think it makes that provision
9 considerably more feasible.
10 I think I'd like to point out that we think
11 that the class exemption has a myriad of conditions
12 that are protective, and that is obviously the thing
13 that people are most concerned about, and I think
14 should be. But it's not like this class exemption is a
15 free pass, by any means.
16 We have sort of bulleted, on pages 7 and 8,
17 the key elements of the protections, including that you
18 have to, in the ERISA world, have a plan fiduciary
19 approve it. So it's not like there's a lot of
20 freelancing going on. There is a level of supervision
21 in terms of the retention of a fiduciary advisor, the
22 monitoring of a fiduciary advisor that's going on at
23 the plan sponsor level, and that's a first key
24 gatekeeper in this process.
25 You have to obviously follow either the level

1 fees or computer model approach. I think the audit
2 condition is a very significant one. There are very
3 few examples of audit conditions in your own class
4 exemptions. There is one in the INHAM exemption. This
5 is more extensive than that one, from what I could
6 tell, with the reporting to the government requirement
7 that's been included.
8 There's compliance procedures that are
9 mandated which will be auditable as well. What I'd
10 like to point out on the off-model advice, there's
11 obviously a particular provision that requires a
12 determination by the advisor that it's in the interest
13 of participants to pursue that and to document it, and
14 to have a record for it.
15 Another point I'd like to make is that it's
16 not like this exemption is covering any Joe Schmoe that
17 wants to offer advice. These are limited. The
18 exemption’s relief is limited to regulated financial
19 entities. These are the same entities, basically, that
20 qualify as investment managers under [sec.] 3(38).
21 [Sec.]3(38) has worked well in terms of who is eligible
22 to be an investment manager: banks, broker-dealers,
23 investment advisors, insurance companies, and the like.
24 All of those regulated entities have their own
25 regulations and statutory schemes that govern them in

1 the provision of their services that overlay on top of
2 this. We have enumerated in our testimony some of the
3 requirements of the Advisors Act, as well as broker-
4 dealer rules. Obviously there's comprehensive
5 disclosure requirements under the Advisors Act; you
6 have to either eliminate your conflicts or fully
7 disclose them. There is obviously a whole overlay of
8 fiduciary duties and liability under the securities
9 law. There are FIRNA rules as well. So these are not
10 entities that are not without regulation outside of the
11 ERISA plan world.
12 I would also like to point out that the ERISA
13 rules themselves are substantial. So basically let's
14 assume an advisor doesn't have a compliance scheme,
15 hasn't followed the very detailed and technical terms
16 of this exemption. There are two types of litigation:
17 individual lawsuits by participants against advisors.
18 I think we've seen a robust class action bar develop,
19 and I'm hoping that doesn't happen here, but you can
20 imagine that that's a possibility.
21 The excise tax rules under the Code are
22 incredibly punitive. I mean, if you ever work through
23 and fill out a [Form] 5330 and you do the pyramiding,
24 and then you multiply it times the number of
25 transactions that a fiduciary advisor may have in this

1 case that might inadvertently be subject to a tax, it's
2 a very substantial penalty scheme. It's just simply
3 not true to say that there's no remedy here, there's no
4 sanction at all.
5 So I'm going to wrap up and say that, in our
6 view, the class exemption includes a comprehensive
7 scheme of regulation for an already comprehensively
8 regulated group of entities that would qualify. We
9 think that there is a strong policy objective that is
10 being vindicated here. We think that the class
11 exemption tries to make more workable the statutory
12 exemption, which has some really significant
13 interpretive complexities. I am going to hold any more
14 comments and take your questions.
15 SECRETARY CAMPBELL: In the elements that were
16 listed in the proposal as requirements for the computer
17 model to consider, one of the questions you raised is,
18 should that be permissive or mandatory. But there was
19 another question that had come up, which was whether
20 that list, by not including fees expressly, was
21 omitting something or whether fees were already being
22 considered by the model, for instance, by virtue of
23 investment returns net of fees and the track history of
24 the investments in the plan. I wonder if you had any
25 thoughts on that.

1 MR. BREYFOGLE: So that the computer model
2 ought to explicitly account for the cost of investments
3 and fees? Is that what you're saying?
4 SECRETARY CAMPBELL: There was a suggestion
5 from some that, for example, the list of things the
6 model should consider--age, risk tolerance--would also
7 include fees.
8 MR. BREYFOGLE: Well, I don't think that there
9 should be any particular prescription of the factors.
10 I mean, it already has to meet a generally accepted
11 investment kind of criteria standard. I mean, that's a
12 separate condition. If you look at the rule in 408(g),
13 it doesn't read as if you have to hit nine different
14 standards before you can qualify as a computer model.
15 I think it's been converted to that in the way it was
16 drafted. I think that it obviously has to be
17 appropriate and to take into account some
18 individualized information, but that could be as little
19 as retirement age. What if you're going to recommend a
20 retirement date fund?
21 What I really care about is when you're going
22 to retire, or your age. I've seen a lot of very
23 complex advice programs that have detailed
24 questionnaires that might solicit every piece of
25 information possible, and those are fine. The

1 individual may not answer half the questions. Does
2 that mean you don't get relief, even if you had a
3 questionnaire and they answered every question?
4 There's also an expense involved when you have
5 a model that has to address eight different variables.
6 Those are sort of the gold-plated, full-service advice
7 products. And they're great products, but not
8 everybody can afford them. Not every plan sponsor is
9 going to want to arrange for that. So, there are
10 different levels of advice programs with different
11 levels of complexity, all of which can get to the basic
12 point of offering some customized advice that's going
13 to focus on diversification, the plan's investment
14 options that are available, et cetera.
15 SECRETARY CAMPBELL: Thank you.
16 MR. DOYLE: Let me ask it just a little
17 differently. We have, as an Agency, been pursuing a
18 number of initiatives to increase transparency of fees,
19 among other things, trying to formulate rules that are
20 going to enhance a participant's ability to take into
21 account not only fees, but other things related to the
22 investment. I think the question is, in the context of
23 the advice provisions, where this requirement that
24 fees--investment management and other fees attendant to
25 the investment--are taken into account. Certainly if

1 the expectation is that participants should be thinking
2 about those things and making decisions, the fiduciary
3 advisor should similarly be taking those things into
4 account and making the recommendations.
5 I think what Brad was trying to get at is that
6 something that is inherent in the concept of generally
7 accepted investment principles? Is that something that
8 we should independently clarify in the context of the
9 regulation and class exemption? Is that something
10 that's typically factored into a computer program when
11 it's making recommendations?
12 MR. BREYFOGLE: I'd say a couple of things.
13 One, is first of all, fee-related conditions are all
14 over this exemption. I mean, obviously the disclosure
15 that's in the exemption is very much focused on fee and
16 other related conflicts, so fees will be fully
17 disclosed. There's the model fee table that's in the
18 regulation that's incorporated into the class
19 exemption, effectively. Fees have to be reasonable for
20 the advice service itself. If you have a fee interest
21 in giving off-model advice, you have to document why
22 it's in the best interest of participants. I would
23 think that from an advisor's perspective, fees would be
24 a relevant consideration. What you are looking at,
25 though, is returns net of fees, I think, generally. So

1 it's not all about fees. It's about returns, it's
2 about diversification, and a variety of things.
3 In terms of, like, the questionnaires that
4 participants fill out in doing an advice product, it
5 typically doesn't survey fees, but I would think it
6 would be relevant, but really from a net return basis.
7 MR. HADLEY: Yes. I think we've always felt
8 that fees are among the things that are important to
9 consider when you're making an investment. Mutual
10 funds do disclose their return net of fees. We have
11 to. You might think about whether that's something
12 that you want to explicitly say. I mean, what you have
13 here are fiduciaries that are either providing advice
14 or are agreeing to have a computer program that's going
15 to provide advice. Explicitly saying that you have to
16 consider this and not something else limits the
17 fiduciary's ability to do his or her job. I don't
18 think I would disagree that a fiduciary, as part of the
19 range of things you consider when you're evaluating an
20 investment, should consider fees --
21 MR. DOYLE: And I think that's all we're
22 really talking about. We, in the regulation and in the
23 class exemption, delineate a number of things that, in
24 giving advice, fiduciary advisors need to think about.
25 The question is whether or how fees and expenses that,

1 again, we're encouraging plan fiduciaries to think
2 about and participants to think about -- how the
3 fiduciary advisor should be required to think about
4 that as a factor or not, in and of itself, as
5 dispositive of anything.
6 Did anyone else have a question on that point?
7 DEPUTY ASSISTANT SECRETARY LEBOWITZ: Not on
8 that point. I still have questions.
9 MR. DOYLE: I had another question on just
10 computer modeling, generally. It was something that
11 was in the ICI's comments. It really went to kind of
12 what should be excluded from the computer model. One
13 of the things that we've been thinking about, the
14 statute kind of contemplates, as does the regulation,
15 that the modeling would be fairly comprehensive with
16 respect to designated investment options.
17 I guess I had a question as to how target date
18 funds, as an investment option, get factored into that.
19 I think the Investment Company Institute suggests they
20 should be taking it out of that mix. I guess, is that
21 necessary? What is the basis for that? Are they not
22 capable of being modeled? What are the issues -- we
23 should start excluding certain types of investments
24 from this overall --
25 MR. BREYFOGLE: Well, I'll take a stab, and

1 Michael will have, probably, some thoughts, too. But a
2 target date fund is meant to be a comprehensive
3 solution. It's really meant to pretty much be your
4 only investment. So when people start investing in
5 target date funds and nine other funds, then they start
6 messing up the strategy of the target date fund.
7 So in the context of a model, you could see a
8 model recommending a target date fund, but to recommend
9 a target date fund and then all of the other funds, I
10 think it's sort of an odd fit.
11 The idea of a model is to produce an
12 allocation of the other funds available in the plan
13 that get you to diversification, that get you to a
14 right risk tolerance for your age, et cetera, that's
15 really more customized than the target date fund
16 itself, which is more age-related and retirement date-
17 related and might not take into account that you have a
18 higher risk tolerance or lower risk tolerance, or you
19 have other assets that the target date fund just
20 doesn't know about and doesn't know how they're
21 invested, doesn't know that you have an annuity,
22 doesn't know that you have all your money in gold,
23 whatever. So I think the idea is that a computer model
24 is going to get to a more customized result for your
25 particular circumstances.

1 In terms of overall reasons to exclude certain
2 things, some plans have 40 or 50 investment options.
3 Some of them are legacy options from mergers, some of
4 them are closed for new investments but still open for
5 old investments. Some of them might be collective
6 trusts or separate accounts that a recordkeeper simply
7 has no basis to evaluate in terms of if they're the
8 ones providing a computer model service.
9 There's a lot of reasons why you may not be
10 able to produce a model that, across a thousand
11 clients, you can account for every single fund they've
12 selected. You might have a platform of 200, 300, 400
13 funds that you make available, and your ability to
14 include them for analytical purposes in a model might
15 be limited.
16 So I think there are some sort of practical
17 workability issues. I think what we're suggesting is
18 that any exclusions that you had be fully disclosed,
19 basically consented to by the plan sponsor, and you'd
20 still be able to produce a diversified allocation and
21 recommendation from the funds that you are accounting
22 for.
23 MR. DOYLE: But it seems to me, in the absence
24 of some degree of specificity as to what could be
25 excluded, you're essentially leaving it to the provider

1 to define what will be included, which I struggle with,
2 how to reconcile that with the idea that the model will
3 take into account the options under the plan.
4 MR. HADLEY: We recognized that and struggled
5 with that as well. But there are these situations, and
6 you've dealt with some of them already, like company
7 stock and self-directed brokerage. What we wanted to
8 point out in our letter was, there are some additional
9 ones. We do agree that you have to be able to build a
10 diversified portfolio, so your exclusions can't knock
11 those out. So things like life cycle funds and legacy
12 funds, you wouldn't need to do that. But we appreciate
13 the struggle you have.
14 MR. DOYLE: One part of it is, okay, we'll
15 model the investment options that are available,
16 setting aside the target date funds. Then I think the
17 issue is, how does that information get to the
18 participant when, in fact, for a lot of participants a
19 target date fund may well be the best choice, they're
20 not active or interested in actively managing their
21 account to the same extent as other participants. So
22 in that context, they're kind of left out of the model.
23 How does that information get presented? I mean, Jon
24 suggested that the model might recommend that, but I'm
25 not sure how that happens unless they're actually

1 factored into the overall package.
2 MR. HADLEY: A typical plan that has target
3 date, as well as an advice option, typically
4 communicates to the participant in a way to say, here
5 are some of the options in figuring out what's right
6 for you. If you want it all in a one-stop shop, here's
7 the target date. If you want a customized portfolio,
8 we have an advice platform for you. If you want to do
9 it yourself, here are the options that are available to
10 you. They sort of choose the path they're going to go
11 under based on what makes sense for them.
12 MR. DOYLE: So this would actually be
13 something the fiduciary advisor might bring to the
14 table in terms of --
15 MR. BREYFOGLE: Right. And you would see in
16 participant communications -- I mean, I don't think we
17 would object to some sort of information requirement
18 that participants be aware of the funds that are
19 excluded, or an explanation of why life cycle funds or
20 target date funds are excluded, and may be an
21 absolutely appropriate choice.
22 MR. DOYLE: Okay. Thank you.
23 DEPUTY ASSISTANT SECRETARY LEBOWITZ: I want
24 to switch gears a little bit. You obviously have a
25 problem with the pattern of practice provision in the

1 exemption that would deny the availability of the
2 exemption for any period during which there is a
3 pattern and practice of non-compliance. You want to
4 speak to that?
5 MR. BREYFOGLE: Yes. Basically, as you all
6 know well, traditionally under an exemption you get the
7 relief for the transactions for which the exemption's
8 terms and conditions are satisfied, and you don't for
9 the transactions where the terms and conditions aren't
10 satisfied.
11 So if I am relying on PTE 84-24 for the sale
12 of insurance contracts and I'm an insurance company,
13 and I have a thousand agents selling insurance products
14 and I'm doing my 84-24 disclosure, et cetera, and 998
15 of them provide the disclosure and the requirements of
16 the exemption are met and two of them don't, I have an
17 excise tax issue and potential remedies applicable to
18 two, which is appropriate. I need to have a compliance
19 scheme in place. I need to be subject to the remedy
20 scheme for those two. But I shouldn't lose the relief
21 for all thousand, where I've had a diligent and
22 appropriate process.
23 The problem with “pattern and practice” is, we
24 don't know what "pattern" or "practice" means. So
25 let's say if --

1 DEPUTY ASSISTANT SECRETARY LEBOWITZ: What if,
2 in this thousand, you had 750 of them that were in
3 violation?
4 MR. BREYFOGLE: Then you should lose the
5 exemption for 750 of them. That is a pretty penal
6 provision.
7 DEPUTY ASSISTANT SECRETARY LEBOWITZ: I guess
8 what I'm getting at here is, you talked earlier about
9 your views about how the exemption satisfies the
10 statutory criteria for the Department, the findings
11 that the Department has to make.
12 MR. BREYFOGLE: Right.
13 DEPUTY ASSISTANT SECRETARY LEBOWITZ: One of
14 those, in addition to the fact that the exemption has
15 to be -- we have to find that it's protective, we also
16 have to find that it's administratively feasible. You
17 focused on administrative feasibility from the
18 perspective of the entity that has to comply with it.
19 I tend to think about it not only in that context, but
20 whether or not effective enforcement and oversight of
21 the exemption itself is feasible for the Department.
22 MR. BREYFOGLE: Right.
23 DEPUTY ASSISTANT SECRETARY LEBOWITZ: That's
24 really what this provision is aimed at. Is it feasible
25 to think that the Department can oversee and enforce

1 the provisions of this exemption which are necessary to
2 meet the other criteria in the statute, that the
3 exemption is protective of participants? Without the
4 ability to recognize in a particular case that an
5 advisor has simply gone beyond the pale, that there's
6 clear evidentiary record not just of individual
7 violations, but of what anyone would conclude is a
8 pattern and practice of either indifference or willful
9 noncompliance.
10 Why should the Department, in seeking to
11 protect participants who are the victims of this
12 unlawful behavior, have to slog through, plan by plan
13 advice by advice, maybe even participant by
14 participant, and make individual assertions of
15 violations in that case? Why shouldn't we be able to
16 take stronger enforcement action and say, for you this
17 exemption just isn't available at all, for anybody,
18 during the period that you've been essentially ignoring
19 the provisions here?
20 MR. BREYFOGLE: I think that one point is,
21 there are many statutory exemptions already that cover
22 conflicts of interest for financial firms: 408(b)(4),
23 408(b)(5), 408(b)(8). There are the four class
24 exemptions that you administratively produced from the
25 early '70s through the mid to late '80s, all covering

1 fiduciary conflicts of interest, and not a single one
2 of them with the kind of rigorous compliance and
3 disclosure scheme that's proposed here. Not a single
4 one of those exemptions has been found by the
5 Department to be subject to abuse. Not a single one of
6 them has a "pattern or practice" exception. Not a
7 single exemption the Department has ever issued has a
8 "pattern or practice" condition. So this is really
9 unheard of. I don't think it's necessary. I would
10 also say that the problem with "pattern and practice"
11 is, it's vague in application.
12 Is a pattern or practice if you have a broker-
13 dealer that has 300 offices, as many do, and there's an
14 office in Florida, in Miami, where there's a problem, a
15 significant problem, but 299 offices are fully
16 compliant, is that a pattern or practice? I don't
17 know. I don't know the answer to that question. The
18 question is, is there a sufficient remedy? I think the
19 answer is yes. The excise tax remedies are self-
20 assessing. They're multiplying. They are pyramiding.
21 In the IRA world, they're not even subject to a limits
22 period. It is a very rigorous scheme. It's also not
23 an area that has been free from litigation.
24 Private enforcement is, let us say, pretty
25 available these days, so it's not that you're just

1 relying on the Labor Department. So I really don't see
2 this as much different than all of the other exemptions
3 that have taken place, except for this exemption scheme
4 is more protective of the ones that haven't been a
5 problem already. There is absolutely nothing that
6 prohibits the Labor Department's investigation or
7 enforcement activity, which is plenary, discovery, et
8 cetera. So I just think the real problem is the
9 vagueness of it and the fact that --
10 DEPUTY ASSISTANT SECRETARY LEBOWITZ: SO if we
11 defined it a little bit better you wouldn't have a
12 problem?
13 MR. BREYFOGLE: I think in the definition,
14 precision would be important. It would be helpful. I
15 still don't think it's necessary.
16 MR. DOYLE: I think one of the other things
17 that we assumed was that, in addition to the annual
18 audit, these fiduciary advisors, for a lot of other
19 reasons, not just ERISA reasons, will be doing some
20 type of internal compliance reviews and therefore the
21 likelihood of having a pattern or practice, except in,
22 I think, egregious cases, should be fairly unlikely.
23 MR. BREYFOGLE: I mean, honestly, representing
24 many financial firms, they're not looking at this class
25 exemption as a free pass. This is not an easy

1 exemption to comply with. It is more difficult to
2 comply than any of the seven or eight statutory or
3 administrative exemptions I've mentioned. I think they
4 are well aware of the litigation risk that's out there
5 and the excise tax penalties. So, to me, I think that
6 people who go into this and look at this in the big,
7 well-advised institutions are going to have very
8 significant compliance programs and schemes in place,
9 and are going to have to.
10 MR. PIACENTINI: Can you elaborate just a
11 little bit more on what you called the litigation risk
12 in the IRA context?
13 MR. BREYFOGLE: Well, I was talking more about
14 the ERISA plan context. There's been a lot of focus in
15 fee litigation there and elsewhere. In the IRA
16 context, it's not that there's no remedy there either.
17 It's just not that there's a remedy under the Code.
18 It's State law claims, which aren't preempted by ERISA.
19 So it's really claims brought under a State law trust
20 type theory and, frankly, it doesn't have the same
21 remedial scheme as ERISA does and that provides
22 sometimes for more relief.
23 MR. HADLEY: A lot of these entities are also
24 regulated under securities laws. So if you're an
25 advisor under the Advisors Act, then there are remedies

1 as well there.

2 MR. PIACENTINI: So we're talking about

3 private actions that would enforce other legal rules,

4 not the conditions of the exemption.

5 MR. BREYFOGLE: In the ERISA world, it's

6 private actions that could enforce the prohibited

7 transaction rules because the exemption conditions

8 aren't met: violation of 406(b), seeking restitution,

9 disgorgement, et cetera. That's the kind of private

10 action that will occur. Obviously you have the excise

11 tax administered by the Service.

12 MR. PIACENTINI: Thank you.

13 DEPUTY ASSISTANT SECRETARY LEBOWITZ: Thank

14 you.

15 MR. BREYFOGLE: Thank you.

16 DEPUTY ASSISTANT SECRETARY LEBOWITZ: Mr.

17 Silvers?

18

19 **AFL-CIO**

20 **By Damon Silvers, Associate General Counsel**

21 MR. SILVERS: Good morning. I understand the

22 schedule was a little earlier even than I had been

23 given warning for, and I apologize if the fact that I

24 was on time was a problem.

25 (Laughter)

1 MR. SILVERS: I'm Damon Silvers. I'm
2 Associate General Counsel of the AFL-CIO. The AFL-CIO
3 has followed this issue for a long time. It was one of
4 the first issues I recall taking up when I started at
5 the Federation a little more than 10 years ago, so
6 we've all seen each other before. The Department has,
7 in my experience, a longstanding substantive concern
8 with this set of issues and, prior to Congress getting
9 involved, had been, I think, quite protective of the
10 interests of plan participants in relationship to
11 advice over the years.
12 For that reason, I think we're a little
13 surprised at this course of events. I'm going to begin
14 by speaking for a moment about process issues
15 associated with the rule, and then move on to
16 substantive issues.
17 The Pension Protection Act was passed two
18 years ago. This rule appeared, obviously, on the eve
19 of a national election with a 45-day comment period
20 shorter than the usual one, and without a hearing. The
21 AFL-CIO, among other parties commenting, requested a
22 hearing. We're all here together today.
23 However, the hearing was on 12 days' notice,
24 with 7 days for submitting comments. That seems a
25 little rushed to us. In fact, we think that the notice

1 here was not adequate. We believe that the entire
2 course of the process associated with this matter is
3 suggestive of motivations and purposes not contemplated
4 in the APA.
5 From process to substance, the purpose of
6 investment advice largely, as an economic matter, is
7 about asset allocation. It is not about the selection
8 of particular funds, except insofar as the selection of
9 particular funds can be steered in a way that is
10 exploitive of plan participants by putting them in
11 products that have higher fees than they might
12 otherwise have.
13 Most of the value that is provided to plan
14 participants is through guiding plan participants on
15 proper asset allocation. I think it's well-known, and
16 you all are familiar with, multiple studies that show
17 that we have a problem in defined contribution plans
18 with participants either investing in asset allocations
19 that don't evolve enough risk--typically money markets-
20 -or those that involve too much risk--tech stocks or
21 whatever the particular vogue of the day is. Getting
22 that balance right and getting it right for people over
23 time in the context of their other holdings is really
24 what we are trying to accomplish here.
25 For that reason, the notion that there's an

1 overwhelming need here to provide investment advice, to
2 ignore conflicts, to move forward in a rushed way to
3 get beyond the computer models, is questionable.
4 Now, the Department ought to be particularly
5 concerned here in relationship to the, I think, well-
6 established economics of providing investment advice to
7 401(k) plan participants. It has been shown over the
8 10 years or so that this issue has been kicking around
9 that for most 401(k) and IRA participants, and
10 particularly for those that the Department ought to be
11 solicitous of, those with assets, say, within one or
12 two multiples of the median plan size of about $30,000,
13 is simply not economical to provide personalized, live,
14 in-person investment advice to people with plan
15 accounts of that size based on a flat fee model. That
16 is why we've had the proliferation of computerized
17 models. Now, obviously for individuals with very large
18 account balances, that kind of personalized live advice
19 is economical. But that, I think, has not been the
20 focus of the Department, nor is it, frankly, the focus
21 of our concerns.
22 Because it's not economical to provide, on a
23 flat fee basis, investment advice to most plan
24 participants, the question that arises when you talk
25 about making exemptions that facilitate providing in-

1 person advice is, what are the economics that you are
2 going to be facilitating? Frankly, as far as we can
3 tell, those economics are either the economics of
4 steering people into either high-free or high-margin
5 products, or the economics of cross-selling, selling
6 other products outside the context of the plan to plan
7 participants. Neither of those purposes are a worthy
8 goal for the Department to be reaching for.
9 Now, what are the dangers? Just to reiterate,
10 in case anyone's missed it in the testimony that you've
11 received and the comments you've received. The dangers
12 here are that it is deeply in the interest of service
13 providers to have plan participants invest in, first,
14 high-fee vehicles, but more importantly, high-margin
15 vehicles. Fee disclosure, to some degree, for
16 sophisticated plan participants who understand the
17 relationship between their investment objectives and
18 the fees, disclosure may help. Margins are completely
19 opaque and disclosure does not reveal.
20 Now, this brings us to the question of the
21 subject you got into with the last witness, which is
22 the question of the relationship of this proposed rule
23 to protecting the rights and interests of plan
24 participants and beneficiaries.
25 As was noted--as I think Alan noted--there's

1 really two sorts of issues here, and perhaps more in
2 the standard under ERISA for promulgating. Here, I
3 want to focus again on the exemption that you were just
4 discussing. There are two criteria: 1) does the posed
5 exemption protect plan beneficiaries and fulfill the
6 purpose of the statute; 2) can it be effectuated? Can
7 the purposes be effectuated, I think, with reference to
8 enforcement? We got into that a moment ago.
9 The AFL-CIO believes that the exemption that
10 is contemplated, which is an exemption that expressly
11 reverts to a bear fiduciary model that was, I think,
12 quite clearly rejected by Congress when it enacted the
13 investment advice provisions of the PPA, simply does
14 not provide adequate protection to plan participants,
15 and is, in fact, not designed to. It is a provision
16 designed with the purpose of facilitating either
17 steering or cross-selling. It does so in explicit
18 contravention of the decision that the Congress of the
19 United States made, which is backed up by two comment
20 letters you've received from the relevant committee
21 chairs, that that model was inadequate for the
22 provision of investment advice.
23 Now, the question of can plan participants be
24 protected under this scheme, if you bought that what
25 I've just said is completely wrong, can you protect

1 plan participants? The AFL-CIO believes that, for the
2 reasons I describe in relation to margins, that
3 disclosure is inadequate and that after-the-fact
4 oversight will be extremely difficult to pick up,
5 whether or not business objectives of the advisor have
6 been sort of interwoven into the advice. The basic
7 fiduciary standards, I think, have proven over time,
8 without explicit conflicts protections, to be
9 inadequate when you have as profound a conflict as you
10 have here.
11 That brings me to the final point of my
12 testimony. Actually, two final points. We sit in the
13 midst of the greatest financial crisis of any of our
14 lifetimes. Every single actor, every single person who
15 has been blamed for it in the private sector was, in
16 some form or fashion, a fiduciary: a fiduciary under
17 business law, a fiduciary under ERISA, a fiduciary
18 under the various securities laws. Pretty much every
19 single human being was a fiduciary. They pretty much
20 in every case were not constrained by those fiduciary
21 duties.
22 What they followed was the compensation
23 structure and the organizational hierarchies that led
24 to other people with compensation structures. When you
25 move from a regime that Congress contemplated where the

1 providers of advice are pretty tightly insulated from
2 conflicts, from compensation structures that encourage
3 them to steer plan participants against the plan
4 participants' interest, to a regime in which they are
5 fully exposed to organizational hierarchies and
6 economic interests to the contrary, you pretty much
7 guarantee that you will get the results that just
8 appeared that cost all of us in the room collectively
9 as taxpayers, and the rest of this country, something
10 on the order of $1 trillion.
11 Finally, two points. There's one other issue
12 imbedded in here that, really, we just think is
13 incomprehensible, which is that the rule provides that
14 advisors may ignore employer stock in the provision of
15 advice. Some people in the industry feel that the rule
16 is not strong enough in letting them ignore employer
17 stock.
18 I think it's widely understood, after Enron,
19 WorldCom, Global Crossing, and Bear Stearns, that large
20 amounts of employer stock in DC plans, particularly
21 where that plan is the employee's only source of
22 retirement security after Social Security, is about the
23 most dangerous thing you can have.
24 The one really powerful reason for getting
25 investment advice is to be told that you need to reduce

1 the amount of employer stock you have in your plan. To
2 allow it to be ignored is to sort of presume that in
3 any circumstance where there's a significant employer
4 stock feature of a plan, that the investment advice has
5 been corrupted.
6 Now, I will conclude by saying this: we all
7 know that in two weeks there's going to be a national
8 election and that the value of this rule may vary
9 somewhat on the outcome, and that in any case the
10 current political appointees are going to change. Some
11 people in this room in the private sector have expended
12 a great deal of time and energy trying to get this rule
13 through that contravenes the statute.
14 I would suggest to them, as I think in a large
15 sense the realities of the political dynamics is that
16 the people behind me are more important than the people
17 in front of me on this matter, that it is a waste of
18 time to enact a rule that is so widely opposed by the
19 people who enacted the statute, and that time and
20 energy might be better spent to try to figure out how a
21 more consensus-based approach could succeed in
22 delivering actual advice that would be useful and
23 properly protective to plan participants, because I do
24 think that it is the case that we all agree that well-
25 crafted disinterested plan participant-focused advice

1 is in everyone's interest.
2 Thank you.
3 MR. DOYLE: Well, I don't know where to start.
4 (Laughter)
5 MR. DOYLE: Let's just start with process. I
6 mean, I don't think it's been a secret that we're
7 interested in getting this particular regulatory
8 initiative completed as soon as we possibly can, taking
9 into account as much of the public comment process as
10 has afforded us the opportunity to consider. I think
11 Assistant Secretary Campbell made that comment in his
12 opening statement. That having been said, do you feel
13 that your comments, your input into this process has
14 been at all compromised by virtue of either the comment
15 period or this hearing notice?
16 MR. SILVERS: Our view is that the rushed way
17 in which this hearing has proceeded has had an effect
18 on our ability to, I think, fully digest the record. I
19 think we believe it has had an impact on the ability of
20 others to participate. The AFL-CIO is a big
21 institution with a lot of people. We are situated to
22 be able to respond to rushed things, but the public at
23 large is not so advantaged.
24 MR. DOYLE: Is there any possibility your
25 views would change if you had more time?

1 MR. SILVERS: They might be better expressed.
2 (Laughter)
3 MR. DOYLE: Just by way of background, I mean,
4 I get the impression from both the comments and your
5 testimony that you did not see the enactment of the
6 statutory exception as a favorable thing. It seemed to
7 me the issues that you raised are issues inherent--
8 assuming they exist; you expressed no comment on that--
9 in the statutory exemption itself.
10 MR. SILVERS: Well, the answer to your
11 question, to use a Washington kind of answer, is yes
12 and no. The AFL-CIO opposed the statutory exemption as
13 it was put forward; I think there's no secret about
14 that. However, there's a big space between where the
15 statutory exemption is and where this draft rule is.
16 While we did not support it--in fact, opposed
17 it--the statutory exemption bears many of the marks of
18 our concerns. It explicitly is not a fiduciary duty-
19 only provision. What really concerns us about the
20 draft rule is that the exemption it provides is a
21 reversion to the fiduciary duty-only model, which we
22 think, A) is not what the statute contemplated, and B)
23 is completely inadequate to this situation.
24 MR. DOYLE: And I guess I struggle with that
25 because you're right, it's not a disclosure-based rule,

1 it's not solely a fiduciary rule. It has some very
2 definitive protections in it, not the least of which is
3 the audit requirements, among others. I think--at
4 least I believe--we implemented in the regulation the
5 literal language of the statute.
6 I guess some have argued, as I think your
7 comments argue, that our interpretation of the fee
8 leveling provisions as reflected in the regulation is
9 inconsistent with congressional intent. That view we
10 put out in 2007. I don't recall having heard those
11 views prior to the time that we proposed those
12 regulations. I'm not singling you out as not having
13 heard those views from, but anyone. I do not recall
14 somebody saying that's inconsistent with our reading of
15 the law. I think the primary reason for that is that
16 any other result, the interpretation you've opposed to
17 be applied in that area, essentially results in the
18 Congress creating a statutory exemption from a
19 situation that otherwise wouldn't be prohibited.
20 MR. SILVERS: I think that this, again, is an
21 issue of not recognizing that there is -- there's a
22 place in between. A) we think that the language of the
23 statute is actually fairly clear in relationship to,
24 say, what constitutes an affiliate and that sort of
25 thing. It may not be terribly convenient for some of

1 the folks who are urging you to move forward with this,
2 but it's pretty clear.
3 Nothing has happened since 2006 which would
4 typically give rise to an exemption, say, of the type
5 of the Sun Trust exemption, where somebody has some new
6 innovative way of doing things and it doesn't really
7 fit the statutory framework, and so you have to figure
8 out, where does it lie. We're talking about exactly
9 the question that Congress contemplated when it put all
10 the substantive protections in place, unchanged since
11 when Congress contemplated it.
12 However, if the view of the Department is that
13 Congress somehow didn't know what it was doing and the
14 Department wishes to step in and fix that, I guess
15 that's your choice to take that point of view. But
16 it's not the only option available to you. The idea
17 that on the one hand you have to have, as you put it, a
18 statute which appears to create an exemption where one
19 is not necessary -- and I'm not going to suggest that I
20 necessarily agree with that, but that's your view. On
21 the other hand, you have the perspective advocated in
22 the rule, which is a reversion to what Congress
23 explicitly rejected.
24 There are alternatives. I was trying to get
25 at that in my last comments to the industry, which are

1 that one could imagine--and I'm not going to go into
2 great detail--a version of this rule that said, if you
3 have a mutual fund complex, a complex financial
4 services firm and you wished to provide investment
5 advice and you wished to do so in person and not
6 through a computer model that fits the computer model
7 exemption, that here are the following things you have
8 to do to wall off the people who are providing that
9 advice from the general managerial and compensation
10 structures of the firm.
11 I'm not suggesting you would do exactly the
12 same things, but there's a history of this sort of
13 thing in the aftermath of the last set of Wall Street
14 scandals around stock analysis, where people get walled
15 off. I'm not saying that we necessarily think that
16 that's the best approach, but it would seem like a
17 reasonable one in relationship to the Department's
18 goals.
19 MR. DOYLE: I won't attempt to speak for the
20 whole Department, but I don't think we think Congress
21 got it wrong. We expressed no views as to whether they
22 got it right or wrong, but were attempting to work with
23 the language that they gave us, which few have
24 indicated is a model of clarity in any respect.
25 I think we attempted to take a fairly reasoned

1 approach to the statute, and I think with respect to
2 the class exemption, try to fill in some of the blanks
3 that Congress clearly left as a drafting matter, and I
4 think as a general investment advice matter as it
5 relates to participants, and IRA beneficiaries in
6 particular.
7 The question--I think part of it--goes to, do
8 we believe everyone who is getting the advice that they
9 need, in fact, has access to that advice? How do we go
10 about, if they're not, facilitating doing that, while
11 at the same being cognizant of the fact that there are
12 conflicts, there are issues here? How do we minimize
13 those? How do we protect participants against those?
14 I think Congress thought they had come up with
15 a framework that was not only disclosure-based, but
16 fiduciary-based, but a framework that actually had some
17 meaningful protections in it. I think the Department,
18 in the regulation, acknowledged those, and in the class
19 exemption tried to build upon those and facilitating
20 the availability of investment advice, while
21 recognizing there are risks, but how do you minimize
22 those risks in the real world in which we exist?
23 I think, too, as others have testified this
24 morning--I happen to agree--in the tumultuous markets
25 that participants are currently involved with, this is

1 probably as important a time for individualized advice
2 as probably there has been, if nothing else, to calm
3 investor concerns.
4 MR. SILVERS: I'm not sure who's asking whom
5 questions here.
6 (Laughter)
7 MR. SILVERS: We, and I think most people who
8 are trying to represent the investor side of this
9 equation, judging by the comments, look at the question
10 of, is there enough investment advice, not unlike
11 someone should have looked at the question of, is there
12 enough mortgage lending. Right. There's lots of
13 people who want mortgages, but in the 2 and 28
14 structure - with a 6 percent interest rate kicker - if
15 that's all that's offered, it's a very different
16 proposition than if people are being given conforming
17 loans. Obviously nobody who was in the decision-making
18 authority position thought that way and we now have the
19 tumultuous markets that you referred to.
20 Our view of investment advice is that of
21 course participants, given the kind of upside down way
22 we've structured our retirement security for most
23 private sector workers at this point, certainly need
24 disinterested investment advice. Being put in what
25 should be a fiduciary context at a time when markets

1 are in great turmoil, facilitating cross-selling seems
2 to me not terribly responsive to the problem.
3 This is a particularly terrible time, in fact,
4 to receive investment advice that is anything other
5 than disinterested.
6 DEPUTY ASSISTANT SECRETARY LEBOWITZ: I just
7 have, I think, one question. Jon Breyfogle, at the
8 beginning of his testimony, talked about his view. He
9 spoke to his view as to the Department's authority,
10 legal authority, to do what we've proposed to do in the
11 class exemption, in particular. Do you take issue with
12 that?
13 MR. SILVERS: Yes, I do. I mean, I think
14 perhaps I wasn't blunt enough. I think the structuring
15 idea of the statute is that there should be explicit
16 firewalls and protections against conflicts of
17 interest--in particular against compensation-related
18 conflicts.
19 When you move from a regime in which the
20 providers of the advice are barred from having those
21 conflicts if they're outside a computer model to a
22 regime where those conflicts are allowed to purvey the
23 structure of compensation and of management of the
24 person providing the advice, with the exception that
25 the person who provides the advice can't actually be

1 paid on some kind of piece rate in relationship to what
2 the decisions are of the person being given the advice.
3 But if that person is being supervised by
4 somebody in a chain who's being paid on essentially
5 whether or not people in general are moving to the
6 higher fee, or more importantly higher margin products,
7 I think you've moved outside of the umbrella of
8 Congressional intent.
9 Now, if you had done what I was suggesting a
10 moment or so ago, which was to look at the situation
11 and what you all believe to be the lack of clarity of
12 the statute, and said, well, we need to have this set
13 of substantive protections that effectively replicates
14 the intention of Congress, well, then you'd be in a
15 different place. But you don't need to ask me these
16 questions. You've got comment letters from the chairs
17 of the committees asserting more or less that what's
18 being proposed in terms of the class exemption is not
19 consistent with the statute.
20 DEPUTY ASSISTANT SECRETARY LEBOWITZ: I heard
21 the authority to grant exemptions, to issue exemptions,
22 has existed since 1974.
23 MR. SILVERS: Oh, no. I'm not suggesting you
24 don't have the authority to issue exemptions.
25 DEPUTY ASSISTANT SECRETARY LEBOWITZ: Some

1 have suggested that the exemption we've proposed here
2 exceeds our exemptive authority.
3 MR. SILVERS: Uh-huh.
4 DEPUTY ASSISTANT SECRETARY LEBOWITZ: And I
5 think what you were saying is that you didn't
6 particularly like what we did or the choices that we
7 made in developing the proposal. But are you or are
8 you not suggesting that we just didn't have the
9 authority to proceed in this area at all?
10 MR. SILVERS: I have not made a study of the
11 question of whether, in the PPA -- if you're asking me,
12 does the PPA have less exemptive authority imbedded in
13 it in this provision than ERISA does in general --
14 DEPUTY ASSISTANT SECRETARY LEBOWITZ: Or does
15 it somehow constrain our otherwise fairly broad
16 exemptive authority?
17 MR. SILVERS: I've not made a study of that.
18 I think that looking at your broad exemptive authority
19 -- I don't believe you have the -- I don't believe you
20 have the authority, even under ERISA generally -- not
21 getting to the question of whether PPA has a narrow
22 exemptive authority, I don't believe that under ERISA,
23 broadly, you have the authority to grant an exemption
24 that is completely contrary to the structure of the
25 statute and the purposes of Congress. I don't think

1 you have that authority. I think that's what you're
2 doing.
3 Now, I think you would have a point, that you
4 have a relatively easier position in litigation to
5 defend under the broad exemptive authority than you
6 might under a different level of exemptive authority.
7 I just simply have not made a study of the question of
8 whether this statute, the PPA, gives you a narrower
9 subject. There are those who have say it does, so I'm
10 willing to take that up.
11 MR. PIACENTINI: Early in your testimony, if I
12 understood, you made the point that the real value
13 added of investment advice is asset allocation rather
14 than specific fund selection. I took that to mean
15 asset allocation across asset classes.
16 MR. SILVERS: That's correct.
17 MR. PIACENTINI: But for that value to be
18 realized by a participant or an IRA holder, don't they
19 have to be able to translate allocation across classes
20 into specific choices of funds? For a relatively
21 unsophisticated investor, how do they do that without
22 some help in knowing how asset classes translate into
23 specific funds?
24 MR. SILVERS: I think that the point of the
25 studies that have looked into this is that if you put

1 your money in the proper asset class baskets, which one
2 you pick within those baskets--which option within,
3 say, the category of equities broadly, but certainly,
4 say, within the category like large cap value or
5 something very specific--is not terribly consequential.
6 Now, the view that we have is that that's
7 actually not true, that in general you have to look
8 carefully -- there are different levels of risk within
9 certainly broad categories like equity that are
10 consequential, but the academic studies suggest that
11 most of the value that is obtained by giving people
12 advice is in getting them into the right asset classes.
13 What flows from this, though, is that once you
14 get people in the right asset classes, there's a
15 tradeoff between getting them very, very specific
16 information about particular funds and the possibility
17 that they'll be systematically steered into high-fee
18 funds. The reason why this is so, is because it's
19 impossible to systematically steer people into high-
20 performing funds because there's a pretty overwhelming
21 body of evidence that there's no such thing over time,
22 that there's no way for anybody sitting at this table,
23 no matter how expert, to tell you who's going to be
24 higher performing next month.
25 You can look at volatility. You can say that

1 a small cap growth fund is likely to be somewhat more
2 volatile than a large cap value fund, for example, but
3 you can't say that as between anyone in that category,
4 who's going to do better later. So weakening the
5 regulatory structure to get that level of advice, you
6 are chasing an illusion and exposing yourself to
7 something very real, which is the danger of excessive
8 fees.
9 MR. PIACENTINI: Just two more questions.
10 I'll try to be brief. Also in your testimony you
11 talked about the economics of different fee
12 arrangements. You made the point that it might not be
13 economical to deliver personal advice--non-computer
14 model, but personal advice--to a modest-sized account
15 holder. So what is the implication of that? Is the
16 implication that a modest-sized account holder who does
17 not have access to computerized advice, because perhaps
18 the options available to them can't be fully modeled,
19 or simply doesn't like computer advice and won't use
20 that option, would only use personal advice, that such
21 investors are better off without advice?
22 MR. SILVERS: No. What I was saying goes to a
23 different -- let me come back to the questions you were
24 posing. When I was addressing this issue of the
25 economics of investment advice, what I was trying to

1 point out is that because it's not economical to
2 provide, on a fee-for-service basis, investment advice
3 to most plan participants -- all but the highest
4 account balance participants. Because it's not, if the
5 industry wants to do it they want to do it for a reason
6 that's not encompassed within the fee they're going to
7 be getting to do it. The reason is either steering or
8 cross-selling, and neither is a legitimate purpose for
9 the Department to be forwarding.
10 Now, the question of what advice to give
11 people. Obviously we would all benefit from having a
12 completely loyal and well-informed expert sitting with
13 us and making our investment decisions for us. That
14 is, by the way, why we have defined benefit plans. But
15 the question that is in front of you is the question
16 of, should you be weakening the substantive protections
17 provided in the PPA by a class exemption in order to
18 get people personalized advice?
19 The point that I've been making is, I'm not
20 sure that the value provided by personalized advice
21 warrants it. The risks associated with the economics
22 of personalized advice are very serious because the
23 business model doesn't work except when it's driven by
24 conflicts.
25 MR. PIACENTINI: So the bottom line of that

1 then is that such participants are better off without
2 personal advice?
3 MR. SILVERS: Oh, no. Let me come back to
4 that for a second. You posited that there was a group
5 of participants whose interests can't be modeled, whose
6 circumstances can't be modeled on a computer model.
7 MR. PIACENTINI: So an IRA holder who has a
8 brokerage account. They have lots and lots of options.
9 MR. SILVERS: Right. Now if you're talking
10 about -- well, again, I would have to get you these
11 studies in writing, because to be honest we are more
12 focused on the ERISA plan, the 401(k) and the 403(b)
13 type of plan participant than the IRA holder. But lots
14 of our members hold IRAs, lots of the public hold IRAs.
15 It's almost never the right answer.
16 The person who has a sufficiently large and
17 diversified individual stock portfolio that they need
18 that level of personalized investment advice is,
19 frankly, not who we're concerned about. We are
20 concerned about the unsophisticated person with a
21 portfolio of mutual funds, which is the typical plan
22 participant.
23 Now, the only circumstance that is discussed
24 in the release about things that can't be modeled is a
25 discussion of employer stock. Employer stock can be

1 modeled. It is, in fact, modeled quite nicely in
2 ERISA: no more than 10 percent in any given person's
3 pension fund. The statement that there are things that
4 can't be modeled is a statement that are things that
5 it's politically impossible to model today, and perhaps
6 it will be politically possible to model in a few
7 weeks.
8 MR. PIACENTINI: My last question is on a
9 different point. You made several references to high-
10 margin investment options. There's a reference in your
11 comment letter that you'd like the profits of the
12 different options to be disclosed. Then I thought I
13 heard in your testimony that, in fact, there is no
14 transparency, there is no available measure of the
15 profitability of different options. Can you --
16 MR. SILVERS: No, those are completely
17 consistent comments. There's no publicly available
18 information. Of course the funds know and it could be
19 easily disclosed, it's just not. I guess I was
20 expressing a certain pessimism about the likelihood
21 that our comment would be enacted.
22 MR. PIACENTINI: Thank you.
23 MR. TAYLOR: You mentioned cross-selling. Is
24 it your point that the exemption in the regulation by
25 encouraging personal advice encourages cross-selling in

1 the way that the regulation standing alone doesn't, and
2 therefore encourages cross-selling? Or is there some
3 other aspect of the exemption that encourages cross
4 selling?
5 MR. SILVERS: My point is that you are
6 weakening the statute in relationship to compensation-
7 related issues and to institutional conflicts through
8 the class exemption, and you are doing so in the
9 service of trying to provide more plan participants
10 with personalized, non-computer-based advice. I
11 believe that's what you're doing.
12 My point is, understand that when you are
13 doing that you are facilitating a business model which
14 depends upon either steering people into high-margin
15 products or cross-selling--high-margin products within
16 the plan or cross-selling--because absent one of those
17 two things, it doesn't make economic sense to provide
18 personalized investment advice to any but the highest
19 account balance plan participants. So then the
20 question is, is that really the sort of thing the
21 Department wants to be encouraging?
22 I mean, look, it's well known among everyone
23 I've ever talked to who's received investment advice
24 outside of the ERISA context: when you go to a firm, it
25 very quickly becomes an effort to sell you more

1 products. That is what you are going to be encouraging
2 and it's going to occur under the fiduciary umbrella,
3 which is really not where it should occur.
4 MR. TAYLOR: It would also be present in the
5 PPA’s level fee advice, too - cross-selling. Is it
6 something peculiar to the other type of advice? Or am
7 I wrong?
8 MR. SILVERS: Well, computer models can be
9 protective against that. If you built in protections
10 in a level fee environment that walled off the people
11 who were providing the advice from the people who were
12 economically and organizationally tied to the larger
13 business -- and there's ways of doing that. It's never
14 perfect, but there are ways of doing that. If you did
15 that, you would diminish the incentive to manage the
16 advice program with cross-selling or steering in mind.
17 I think it's a certainty, if you enact what you're
18 proposing, that investment advice will be managed with
19 cross-selling as the primary objective.
20 MR. DOYLE: It seems to me if we accept the
21 proposition that you put forward of cross-selling and
22 directing as being inherent in economically affordable
23 advice, it suggests that then independent advice isn't
24 affordable or can't be offered on a cost-effective
25 basis.

1 MR. SILVERS: It's computerized. The
2 financial engine, these people generally offer
3 computerized-based --
4 MR. DOYLE: So anything short of computerized
5 advice.
6 MR. SILVERS: I think what we know from --
7 MR. DOYLE: And is that enough?
8 MR. SILVERS: I think what we know from the
9 experience over the last 10 years is that computerized
10 advice is, on an independent basis with no cross-
11 selling or other extraneous economic objectives on the
12 part of the institution giving the advice, I think we
13 know that that is economical for relatively small plan
14 balances. We know that's true. I think we also know
15 that, in general, personalized advice is not provided
16 except at very high account balances. I think that's
17 also true under the current state of affairs.
18 Now, if we want to move to a world in which
19 people have more personalized advice and we want to do
20 so, then we need to recognize that if we're doing that
21 we are bringing with it a lot of extraneous issues, and
22 perhaps conflicted--more than conflicted problems.
23 We're bringing with it objectives on the part of those
24 people providing the advice that are not related to
25 what the person seeking the advice, who is after all

1 the beneficiary of the fiduciary relationship, is
2 looking for.
3 Now, there are some things that are so
4 important, so valuable in this world that we tolerate
5 all kinds of negative side effects associated with
6 them. I suppose that one could conclude that
7 personalized investment advice is the sort of thing
8 that -- we're willing to tolerate all kinds of mischief
9 associated with it in order to get a little bit of it
10 there. I know some people in the mutual fund industry
11 who believe that that's true, and I take them at their
12 word, that they think that the business model here is
13 cross-selling, and that if it takes cross-selling to
14 get the personalized advice, well, so be it.
15 My point to you, I guess, is that if you
16 believe that--and we have really deep skepticism about
17 that because of what I said earlier about asset
18 allocation being really the important piece here--then
19 the way you should be proceeding is to look to see how
20 you can get to a middle point where you've got
21 sufficient sort of Chinese walls, that you're not going
22 to get rid of the cross-selling, you're not going to
23 get rid of potentially all the steering that may go on,
24 but to minimize it and to create independent lines of
25 authority and compensation so that the people who are

1 providing the advice have some sense of vocation beyond
2 cross-selling.
3 I would submit that if you don't do that, then
4 A) you run a pretty serious risk that people are going
5 to end up with the wrong stuff, with the wrong products
6 in their portfolios, but also I think that plan
7 participants will often be disappointed, that they will
8 be seeking advice and that they will receive a sales
9 pitch.
10 MR. DOYLE: I think we share the same goal in
11 that regard. I mean, we'd welcome your suggestions as
12 to how we might further strengthen that. I think we
13 attempted to take, at least based on the comments,
14 perhaps, exceptionally broad approach to defining the
15 extent to which compensation could not be taken into
16 account and based on the investment advice that's being
17 given.
18 DEPUTY ASSISTANT SECRETARY LEBOWITZ: Thank
19 you very much.
20 MR. SILVERS: Thank you.
21 DEPUTY ASSISTANT SECRETARY LEBOWITZ: I think
22 after Mr. Silvers' testimony, I think we need a break
23 so we can get back on schedule.
24 (Laughter)
25 DEPUTY ASSISTANT SECRETARY LEBOWITZ: So why

1 don't we take a 10-minute break.
2 (Whereupon, at 10:06 a.m. the meeting was
3 recessed and resumed back on the record at 10:22 a.m.)
4 DEPUTY ASSISTANT SECRETARY LEBOWITZ: Let's
5 reconvene.
6 Welcome, Mr. Certner, on behalf of AARP.
7
8
9 **AARP**
10 **By David Certner, Legislative Counsel and**
11 **Legislative Policy Director**
12 MR. CERTNER: Members of the panel, I'm David
13 Certner, Legislative Counsel and Legislative Policy
14 Director at AARP. Thank you for convening this
15 hearing. We appreciate the opportunity to discuss
16 these important issues surrounding a class exemption
17 for investment advice.
18 Investing for retirement under an ERISA plan
19 is not the same as investing for other reasons.
20 Indeed, we believe there is a far greater degree of
21 participant protection required in the employment
22 setting. First, individuals and employers receive
23 significant tax subsidies to invest in retirement
24 plans--an estimated cost of about $100 billion for the
25 current fiscal year--and in addition, a time horizon

1 showing much longer than further types of investment.
2 The fundamental purpose of ERISA, as you know,
3 is to protect participants and to ensure that
4 participants have accumulated an adequate amount of
5 assets to live comfortably in retirement. We believe
6 that the proposed regulation and class exemption do
7 neither. In fact, both the proposed regulation and the
8 exemption go well beyond the plain language of the
9 statute, and from our point of view are clearly
10 contrary to the intent of Congress.
11 The plain language of the investment advice
12 provisions of the Pension Protection Act, along with
13 its legislative history, clearly demonstrates that the
14 proposed class exemption exceeds the scope of the hard
15 fought compromise reached by Congress.
16 ERISA generally prohibits transactions between
17 plans and parties and interests where there are
18 conflicts of interest. Such inherent conflicts of
19 interest include the provision of conflicted investment
20 advice. As you know, the PPA permits two limited
21 exceptions to this general prohibition. The first is
22 with the advice provided pursuant to a fee leveling
23 arrangement, and the second is where the advice is
24 provided pursuant to an arrangement that uses a
25 certified computer model.

1 Now, the PPA was carefully constructed to
2 protect participants from conflicted investment advice,
3 and these two narrow exceptions were the only
4 exceptions permitted. As the Department is well aware,
5 these issues were not only hotly debated in the
6 conference committee, they were long debated over
7 several Congresses.
8 As you are also aware, broader bills
9 introduced in both the House and the House-passed
10 legislation were ultimately rejected in conference.
11 Indeed, the Senate overwhelmingly--it was a 97:2 vote--
12 included a provision that rejected the House approach
13 and instead encouraged independent investment advice,
14 consistent with the general statutory framework that
15 protected participants against conflicted investment
16 advice.
17 During a discussion surrounding the enactment
18 of the PPA, the House and Senate negotiated a
19 compromise of the investment advice provisions. We
20 note, and I'm sure that you are well aware, that the
21 three lead Senators most involved in those
22 negotiations--Senators Kennedy, Grassley, and
23 Bingaman--have already provided comments to the
24 Department concerning those negotiations and the intent
25 of Congress.

1 They note in their letter that the investment
2 advice provisions of the PPA itself were the result of
3 a careful compromise and they reject the Department's
4 approach as contravening both the intent and the plain
5 language of the PPA.
6 In addition, the Senators make the point that
7 the Department has seemingly ignored much of this
8 thoughtful debate in the PPA in now allowing conflicts
9 of interest to impact workers' retirement savings. We
10 agree that the Department appears to have largely
11 ignored the legislative reality.
12 Under the canons of statutory construction,
13 any interpretation of an exemption or exception to a
14 general prohibition must be narrowly construed. By
15 disregarding the statute and the legislative history
16 and broadly construing these exemptions under ERISA's
17 prohibited transaction rules, we think the Department
18 has acted in an arbitrary and capricious manner. Not
19 only does the Department ignore this tenet of statutory
20 construction, but worse yet, by doing so it broadly
21 undercuts ERISA's protection of workers' retirement
22 benefits.
23 We think the proposals go beyond the statute
24 in numerous ways, and let me enumerate. First, certain
25 affiliates of an advisor are excluded from the

1 requirements of fee leveling. The only entity covered
2 is the individual actually providing the advice. Even
3 though the advisor and affiliate may be closely related
4 and the profitability of the affiliate is dependent on
5 the investor's sales performance, the proposals ignore
6 this relationship. This failure to include affiliates
7 within the fee leveling requirement is exactly the type
8 of conflicted advice that Congress sought to prevent.
9 Second, by ignoring incentives other than
10 direct compensation, the class exemption ignores how
11 advisors and their affiliates are incentivized to
12 provide advice and to sell products. The statute
13 provides that fees will not vary depending on the basis
14 of any investment option selected.
15 The proposals, however, permit advisors to
16 actually steer participants towards investments that
17 are more lucrative to the advisor and the affiliate,
18 and whether it is through direct or indirect payments,
19 the end is the same and the exemption permits practices
20 that we believe go well beyond those that were
21 permitted by Congress.
22 Third, the purpose behind the exception
23 permitting the use of the computer model was to create
24 an independently certified and objective source to
25 provide the unbiased investment advice. Congress made

1 it clear that the computer model was to be used
2 exclusively, not merely for "context". Ignoring the
3 statutory limitation opens a huge non-enforceable hole
4 in the statute to provide conflicted advice.
5 Fourth, the proposal permits the advisor to
6 initiate investment advice after receipt of advice
7 through a computer model. This is in direct
8 contradiction of the language which states that any
9 investment transaction pursuant to the advice must
10 occur solely at the direction of the participant or
11 beneficiary.
12 Fifth, the proposals permit the advisors to
13 ignore the advice generated by the computer model, with
14 a rationale for doing so only required after the one-
15 on-one meeting. Disclosures provided after the
16 participant has mentally committed to following the
17 advice are really of little value. We believe that
18 these direct contradictions of the statute all exceed
19 the Secretary's authority.
20 Indeed, to us it appears that in a number of
21 instances the Department's class exemption and proposed
22 regulations are actually interpreting the House-passed
23 bill, H.R. 2830, and not the Pension Protection Act.
24 For example, H.R. 2830 permitted fees to vary based on
25 the advice provided and investment products purchased.

1 In contrast, the PPA requires that fees, directly or
2 indirectly, cannot "vary depending on the basis of any
3 investment option selected."
4 Although H.R. 2830 required the advisor to
5 provide written disclosure of conflicts at a time
6 reasonably contemporaneous with the initial provision
7 of advice, the PPA requires such disclosures before the
8 initial provision of investment advice. These are two
9 examples where the Department has ignored the clear
10 legislative history that led to the PPA's statutory
11 language, which has resulted in direct contradictions
12 of the statute, which again we think exceed the
13 Secretary's authority.
14 Unfortunately, the financial sophistication of
15 the typical investor is more the exception than the
16 rule. Research shows that the financial illiteracy,
17 quite frankly, is widespread among the general
18 population and is particularly acute among certain
19 groups. As a result, the proposed regulation and class
20 exemption are really simply inadequate to protect
21 participants.
22 Much of the literature demonstrates that
23 investment advisors very often can push investments
24 that may be unsuitable and risky for investors, and
25 even sophisticated investors often purchase investments

1 which they claim not to have fully understood. There
2 is an entire body of behavioral research that has been
3 done around these questions and basically manipulation
4 of investors, and I think it's critical that the
5 Department take a look at some of this research, which
6 really goes to the heart of what we're talking about
7 here in allowing these kinds of advice.
8 So I would ask to also submit for the record
9 -- we have actually put together an entire research set
10 of issues on this behavioral analysis which we would
11 like the Department to consider when looking at this
12 investment advice issue.
13 As the Department itself noted in their
14 preamble, many participants with self-directed accounts
15 are not particularly sophisticated, but these accounts
16 still may be the largest pool of assets, besides their
17 home, that they own.
18 Advisors generally seek to develop a trust
19 relationship with a client. In the employment context,
20 where very often there is absent the longstanding
21 relationship, then the trust is actually generated in a
22 different way. Here, the trust is really generated due
23 to the fact that the employer or the plan has, in
24 essence, chosen the advisor. In effect, the advisor
25 chosen by the employer assumes this air of credibility

1 because they've now been sanctioned by the employer.
2 But it is exactly in this type of environment
3 that ERISA has been designed to protect the participant
4 and it should be particularly true, as was mentioned
5 earlier, in the current financial environment, with the
6 economic uncertainty, the wild market fluctuations, and
7 financial firms, quite frankly, teetering on
8 bankruptcy, it is exactly in this type of environment
9 that a financial advisor may feel the greatest pressure
10 to not act solely in the best interests of individuals.
11 I really think it's worth noting here, at the
12 very heart of the financial scandals that have rocked
13 the nation - not just now but really going back to the
14 early part of the decade, scandals with Enron, with
15 WorldCom, now that have permeated through Lehman
16 Brothers, AIG, and much of Wall Street - at the very
17 heart of every one of these scandals are conflicts of
18 interest.
19 Much of the debate in the past few weeks has
20 focused on the failure of the regulatory agencies to
21 step in and address the underlying conflicts of
22 interest that drove our financial system off track. I
23 think it is within that context and with that
24 understanding that we really emphasize that the
25 Department should reevaluate the position taken here in

1 allowing conflicts of interest into ERISA in the broad
2 way that has been done in the class exemption and the
3 regulation.
4 We would submit for you that disclosure alone
5 is not a remedy. As the Financial Planner Standards of
6 Conduct states, "Individual consumers possess
7 substantial barriers resulting from behavioral biases
8 to the provision of informed consent, even after full
9 disclosure. Moreover, not only can marketers who are
10 familiar with behavioral research manipulate consumers
11 by taking advantage of weaknesses in human cognition,
12 but competitive pressures almost guarantee that they
13 will do so." Again, I will refer you to some of the
14 research that we have and will leave for the record.
15 The Department has already seen some of the
16 difficulty--we have talked about some of these things
17 earlier--in producing a fee disclosure form that is
18 readily understandable, provides all the information
19 that a participant needs to make an informed decision,
20 but is not overwhelming and is presented to the
21 participant in a timely fashion.
22 Just this one area of lack of sophistication
23 also indicates that participants really need more
24 protection rather than less to ensure that they do not
25 become taken advantage of. Significantly, under the

1 proposed regulation and class exemption, participants
2 are deemed then to have made a decision. Even if there
3 is undue pressure from advisors, participants are,
4 quite frankly, left with no remedy for excessive fees
5 or poor advice in connection with the receipt of
6 investment advice in the investment products chosen.
7 Although under traditional trust law a breach
8 of fiduciary duty would result in more relief, that is
9 generally not the case now under ERISA. Although I
10 know the Department has advocated in the courts to
11 broaden remedial relief, here the Department is
12 essentially taking a position that would leave the
13 participants with less protection and no relief.
14 Finally, we would urge, if the Department
15 refuses to rescind this regulation and class exemption,
16 that the effective date should at least be one year
17 from publication. This would at least permit
18 employers, who really are the linchpin here in
19 providing advice, and financial advisors to establish
20 systems to meet these new requirements, as well as to
21 permit, quite frankly, the financial markets to settle
22 down some.
23 In closing, in order to comply with ERISA, as
24 you know, the Secretary must make findings that
25 issuance of the exemption is in the interest of a plan

1 and the participants and beneficiaries, and is
2 protective of the rights of beneficiaries. We submit
3 that increasing access to investment advice for
4 individual account plan participants alone is not
5 enough for a finding that this class exemption is in
6 their best interests.
7 Based upon the information from AARP and other
8 commentators, including some that the commentators from
9 the Hill have provided, we think the Department is,
10 quite frankly, hard pressed to make the required
11 findings. We submit that the Department should rescind
12 the proposed regulation and class exemption so that
13 they are consistent with the statutory language and
14 intent of Congress. Again, we look forward to
15 continuing to work with you in a way to ensure that
16 beneficiaries and participants are protected from
17 conflicts of interest.
18 Thank you for the opportunity to testify.
19 MR. PIACENTINI: I guess I'll start by saying
20 I certainly appreciate your attention to the research
21 that helps us understand the economics and the
22 behavioral issues surrounding investment advice, and I
23 look forward to looking at some of what you are
24 providing. I think, as you've read our proposal and
25 the economic assessment of it that we prepared, you

1 know that we have reviewed some of the literature
2 already.
3 Certainly we've looked at the behavioral
4 literature that helps us understand the kinds of
5 investment mistakes people make and the potential for
6 good advice to correct those mistakes, and we've also
7 looked at literature on conflicts and on some of the
8 potential harms that they can cause, and I think that
9 was the reason for some of the very thorough
10 protections that were included as conditions of the
11 exemption.
12 So I guess what I would do is invite you to
13 maybe help prepare me a little bit for digesting
14 whatever additional research might be included in your
15 submission for the record. Where exactly in that
16 equation does this add insights that maybe we were
17 lacking before?
18 MR. CERTNER: Well, I think it really
19 emphasizes the point about how easy it is for even
20 sophisticated investors to be manipulated by investment
21 advisors. I think that's really the fundamental point
22 that's in here. For the most part, we're not talking
23 about sophisticated investors in this context, but less
24 sophisticated investors. So there are some real
25 potential dangers in terms of steering and

1 inappropriate products that can arise, we think, in
2 this context.
3 We think that the conflict of interest
4 prohibitions, what we think was the intent of the PPA
5 to keep those conflicts really at bay, really go to the
6 heart of what our problems are with what has been done
7 in the regulation and the class exemptions here.
8 I heard some of the earlier comments about,
9 well, isn't bad advice better than no advice? We have
10 sort of heard this argument made now for, quite
11 frankly, almost 10 years. That is a false choice. The
12 real answer is, you know, we want people to get good
13 advice, and good advice means basically people who have
14 not another interest other than the interests of the
15 participants and beneficiaries.
16 Clearly, in this context we have people who do
17 have other interests and don't have the interests of
18 the participant and beneficiary as their sole interest
19 here. That is what, I think, over the years of this
20 debate has been kept at bay, and we think that part of
21 what was done in the statute was to try to prevent that
22 kind of conflict from creeping in.
23 A computer model was deemed, for example,
24 acceptable because the computer model was this
25 independently verified, certified model, but it was

1 also more of an objective standard. You have this
2 model, you can go back and look at the computer model
3 to see if there were any problems pertaining to it.
4 Quite frankly, when you have one-on-one types of
5 discussions with people, the kinds of things that
6 happen in that room really become unenforceable from
7 the Department's perspective. There is no more
8 objective standard that can be used.
9 So that is why there is, I think, a bright
10 line between using something like an objective computer
11 model and having an individual conflicted advisor
12 having one-on-one conversations.
13 MR. DOYLE: But I get the sense you're even
14 troubled by the statutory construction in terms of the
15 fee leveling and computer modeling. Is that right?
16 MR. CERTNER: As you know, we were heavily
17 involved in the debates on this issue going back to --
18 I believe it was originally introduced maybe even in
19 1999, and had been involved in some of the legislative
20 work on this issue right up through the conference
21 committee. We were comfortable, quite frankly, with
22 use of the computer model because we do want people to
23 get investment advice. We have felt before, and we
24 think now it's even more critical, that people do get
25 some additional advice.

1 These 401(k) plans are obviously putting a lot
2 of responsibility on individuals. It would be nice,
3 and I think this was noted earlier, if each individual
4 came with their own advisor who could objectively give
5 them information. For the most part, I don't know that
6 that's really quite financially viable, although some
7 employers do provide that kind of availability to
8 individuals. But we do know that a computer model can
9 work and can provide some of the basic analysis that
10 people need. Now, is it enough? No, it's still
11 problematic, because even a computer model for many
12 people is still difficult and they may not be sure what
13 to input or how to even interpret what they're putting
14 in and what they're getting out.
15 In the best of all possible worlds, we'd have
16 additional hand-holding. But having said that, we know
17 that computer models, when they're used, can work and
18 can provide really the basics for individuals who are
19 trying to figure out how to best diversify their
20 holdings.
21 So we were not uncomfortable, certainly, with
22 the computer model and we believe that that's where
23 Congress ended up as well. It's when you step beyond
24 the computer model and allow this one-on-one kind of
25 counseling to really -- and I think your words were,

1 well, the computer model was only to be used as the
2 context, not as actually the guidance itself, that
3 you've moved beyond what we think was both what the
4 statute says, what the intent of Congress and the
5 negotiators were, and I think it was very clearly
6 expressed in the letter you got from the Senators.
7 That was certainly our understanding at the
8 time of the passage of this bill as well about what
9 that exception meant. So we're not troubled at all by
10 using the computer model. The fee leveling, again, was
11 an attempt to try to remove conflicts of interest from
12 the kinds of counseling somebody might get. I'm not
13 sure that we were as convinced that that was as
14 necessary or needed, and we would have preferred, quite
15 frankly, to see this statute going in another
16 direction. But both of those provisions had at their
17 heart the notion that we're going to keep these
18 conflicts of interest at bay by using these two narrow
19 exceptions.
20 MR. DOYLE: Well, I guess from our
21 perspective, we, I think like a lot of the employee
22 benefits community generally, struggled to try to make
23 sense out of what Congress left us to work with in this
24 area, and does lack a fair degree of clarity. But
25 there are some things that are clear, and I think

1 Congress clearly laid out some protections in an effort
2 to address the conflicts.
3 But setting aside our interpretation of the
4 fee leveling provisions, just think about it as a
5 practical standpoint, that if we accept the analysis
6 that you've put forward, and others, in terms of the
7 scope of the fee leveling requirement, just taking into
8 account our prior guidance, which we don't believe
9 Congress intended to displace, we end up with a
10 circumstance where you don't have conflict and
11 therefore you don't have a prohibited transaction with
12 respect to what you need a statutory exemption for. So
13 is it conceivable Congress intended to create a
14 statutory exemption in an environment where you
15 otherwise wouldn't have a prohibited transaction?
16 Again, looking at the literal language of the statute
17 that we were given, and against that backdrop, I think
18 our analysis was fairly well reasoned.
19 MR. CERTNER: Well, it may be well reasoned
20 from your perspective, but I do think that in the
21 context of this conference committee that really was
22 trying to prevent conflicts of interest where you had
23 certainly overwhelming votes, where you had an
24 independent vote in the Senate on this one provision
25 alone, where you had just overwhelming bipartisan

1 rejection of essentially the House approach, and the
2 support of really trying to encourage the provision of
3 more independent, non-biased investment advice. That
4 was the whole thrust of the Senate's positions on that
5 bill.
6 I think when you look at it in that context
7 and the changes that were made in the conference
8 committee which narrowed the broader reading which I
9 think you've given, which was more like what was in the
10 House-passed bill, I think when you look in that
11 context and you look at it in terms of the statutory
12 construction and narrow interpretations of statutory
13 exemptions, quite frankly I think your interpretation,
14 while reasonable, is overly broad and is not
15 appropriate in the context of this statute.
16 MR. DOYLE: I guess the other point I'd make
17 in terms of individualized advice, which I think the
18 legislation dealt with less clearly but there is an
19 indication that they at least contemplated that
20 following the receipt of computerized modeled advice,
21 there would be circumstances when participants might
22 need more and could seek more so long as it was solely
23 acting on their own behalf. The statute is somewhat
24 incomplete in terms of that thought, in terms of where
25 that was intended to go.

1 Again, I think part of what the Department was
2 trying to do in the class exemption was, one, recognize
3 that there are participants who won't necessarily
4 benefit from modeled advice, and on the other hand,
5 would benefit from some individual advice, both with
6 respect to understanding the models, as well as outside
7 the modeled context where modeling might not be
8 available. Again, I think to try to fill in some of
9 the holes that perhaps Congress left in drafting this
10 well-crafted compromise.
11 MR. CERTNER: I would acknowledge that the
12 statute may not be crystal clear to you, although I
13 think that some of the follow-up submissions you've had
14 from some of the members of Congress have tried to help
15 clarify that, and I think they go in a very different
16 direction than where the Department is going.
17 I am, quite frankly, not sure why, when we're
18 interpreting a narrow exemption, the Department feels
19 that it should substitute its own judgment for the
20 judgments that they're now getting from the folks who
21 actually wrote this statute. So that's one thing I'm
22 confused about. Secondly, I'm not sure the Department
23 has done enough to try to encourage the provision of
24 independent investment advice. That was the whole
25 direction that the Senate bill was going, which was

1 trying to encourage independent investment advice.
2 One of the barriers that we have out there is
3 really at the employer level, because obviously the
4 employer is the one who's setting up these arrangements
5 in the first place. The employers, quite frankly, are
6 not comfortable with providing conflicted investment
7 advice. The employers, obviously, are nervous about
8 their responsibility, their fiduciary responsibility,
9 and whether or not they're basically going to be liable
10 for any problems that occur in any advice that's given.
11 The employers would like greater and better
12 protection. In essence, if they do it, what they need
13 to do to provide that kind of investment advice?
14 I do not think that employers are going to be
15 particularly comfortable with a standard that allows
16 this kind of conflicted advice to happen because
17 employers are then going to be more on the hook because
18 employers do have a duty, as you well know, to
19 essentially monitor and oversee what is going on in
20 their plan, which would include the provision of
21 investment advice.
22 So I think it would serve beneficiaries, would
23 serve employers, would serve the whole system better if
24 the Department would do more to lay out, quite frankly,
25 of the fiduciary responsibilities, or fiduciary steps,

1 the fiduciary issues that would be necessary for the
2 provision of independent investment advice; in short,
3 to give really primarily employers more comfort that if
4 they take certain steps under ERISA, that they will not
5 be liable for potential problems that may have
6 happened, for example, just in the last month alone in
7 the markets. Obviously if employers are taking the
8 right steps and doing the right oversight, they're not
9 responsible if the advice turns out to be bad.
10 Right now, that's a level where there is not,
11 I think, enough comfort at the employer level.
12 Employers are going to be far less comfortable with
13 this provision of conflicted advice and the
14 possibilities for their liability continuing for not
15 having proper oversight of what's going on in these
16 one-on-one consultations, as opposed to the steps the
17 Department could be putting forward to actually show
18 the best ways to provide an independent advisor to an
19 individual, and a way of basically insulating
20 yourselves from liability. That would, in turn,
21 encourage more of the independent investment advice.
22 That goes back to what I said earlier. The choice
23 should not be here between bad advice and no advice, it
24 should be, how do we get good advice to people?
25 MR. DOYLE: Do you start from the proposition

1 that any advice under this scenario is going to be bad
2 advice?
3 MR. CERTNER: No. I start from the
4 proposition that the --
5 MR. DOYLE: The potential.
6 MR. CERTNER: -- we should be trying to get
7 the better advice, because advice is an important
8 component for individuals and we do want to encourage
9 that. Over the past decade we think that more and more
10 advice has been looked at by employers, has been
11 provided more to individuals primarily through computer
12 modeling, but we think we should be able to expand the
13 direction that that independent advice was going rather
14 than getting off track and allowing conflicted advice.
15 MR. DOYLE: So you support individual advice,
16 you just differ on how to get there?
17 MR. CERTNER: We support having independent,
18 objective, individualized advice. Unfortunately,
19 today, thus far it has not necessarily been financially
20 easy to accomplish that, either from the employer
21 perspective or the individual perspective.
22 MR. PIACENTINI: I'd like to circle back and
23 follow up just a little bit, if I could. So I think I
24 understood you to say, in response to my earlier
25 question, that in this research that maybe we hadn't

1 considered fully before there is evidence that
2 investors can be manipulated. But the follow-on
3 question to that, if there is support for that in the
4 research, is whether they will be manipulated.
5 Certainly the investors themselves, in their
6 own surveillance, if you will, of the advice they're
7 getting, it's not the only protection included in these
8 exemptions. There are also substantive standards of
9 unbiasness and so forth. There are procedural
10 protections around documentation and so forth. There's
11 a mechanism of audits which are intended to be
12 independent and with some notification to the
13 Department of problems, at least as all this was
14 proposed.
15 So I guess my question then is, in the
16 research or in other knowledge or information you have
17 available to you, if you have evidence on the degree to
18 which individuals can be manipulated, do you also have
19 evidence on the degree to which these other protections
20 are or are not effective?
21 MR. CERTNER: I think what we're trying to do
22 is prevent some of these problems from arising in the
23 first place. It's much more difficult to, after the
24 fact, unwind them, whether it's to take legal action or
25 other action to try to undue any problems that occur.

1 So I think that's part of the framework of ERISA, is to
2 try to prevent some of these problems from arising in
3 the first place.
4 That's why you have some of the conflict of
5 interest protections, is to prevent some of this from
6 arising in the first place. So if you allow these
7 conflicts in and you essentially allow problems to
8 occur, it becomes very difficult then with audits on
9 the back end to undo the problems that have occurred
10 and doesn't really, I think, help the situation, quite
11 frankly.
12 MR. PIACENTINI: Okay. Thank you for that.
13 Then one separate question. You spoke just
14 now about your view of how the Department might have
15 taken, or could take, a different approach that could
16 encourage the provision of advice, what you would
17 consider to be better, more independent advice in DC
18 plans, where you focused on the employer as a decision-
19 maker about whether advice would be offered.
20 But I guess then my follow-up question to that
21 has to do with IRAs. There is more money now in IRAs
22 than there is in private DC plans. The account
23 balances in many instances can be larger. They include
24 roll-overs from maybe several jobs, people at more
25 advanced ages. You don't have a pre-selected menu of

1 choices. You've got more of an open-ended set of
2 choices. You don't have a fiduciary sort of standing
3 there in between. So in some sense there the questions
4 of access to good advice might even loom larger, at
5 least in some cases.
6 So what do you think about the availability of
7 advice to people in their IRAs?
8 MR. CERTNER: Well, I think you raise a good
9 question because I think that is a much more difficult
10 context, quite frankly. You've now removed yourself
11 from that kind of employer fiduciary environment where
12 you have clear authority for the employer to oversee
13 and play a role here. I think in that individual
14 setting, quite frankly, it is much more difficult.
15 Quite frankly, I'm not sure what the best answer is in
16 that kind of context.
17 Clearly, using some objective certified
18 computer models if they are possible in that kind of a
19 setting, and I think they may be at least in terms of
20 being able to achieve some level of broad
21 diversification, then there's probably an appropriate
22 use of the computer modeling in that situation. Quite
23 frankly, that may be enough and that may be the best we
24 can do outside of the individual in that context,
25 essentially being the one who seeks out and pays for

1 their own advice.
2 MR. PIACENTINI: Thanks.
3 DEPUTY ASSISTANT SECRETARY LEBOWITZ: Earlier
4 in their testimony, the Investment Company Institute
5 representatives, and in their written submissions,
6 urged the Department to delete the provision in the
7 class exemption, that the exemption won't be available
8 during any period with respect to which there's a
9 pattern or practice of non-compliance.
10 They said that it was unnecessary and
11 enforcement would be adequate on a transaction-by-
12 transaction basis rather than giving the Department the
13 authority to assert, at least, that the exemption is
14 simply unavailable in that circumstance where there's
15 essentially a pattern or practice of egregious
16 violations.
17 Do you have a view of their recommendation or
18 do you share that, or oppose it?
19 MR. CERTNER: I'm certainly not familiar with
20 their written comment. But just listening to your
21 description of it, if I understand it, it seems to me
22 that the Department's job here, the job of the
23 regulators here, is to protect the participants and
24 individuals. So if we are talking about a pattern or
25 practice of egregious conduct, I don't see why the

1 Department wouldn't have the broad authority here to
2 simply shut down that -- altogether.
3 I mean, we're looking to protect the
4 participants and beneficiaries. I don't understand how
5 we would say, if we have a broad pattern or practice
6 we've demonstrated, that somehow these few people who
7 may be on the outside are somehow better protected. I
8 think if we're showing a broad pattern or practice of
9 misconduct, that the Department should have broader
10 authority in this area.
11 DEPUTY ASSISTANT SECRETARY LEBOWITZ: Okay.
12 Thank you.
13 Our next witness is William Ryan.
14
15 **SIFMA**
16 **By William Ryan, Executive Director**
17 **Legal and Compliance Division (ERISA Law)**
18 **Morgan Stanley**
19 MR. RYAN: Good morning. I will do my best to
20 endeavor to stay within the time frames.
21 My name is Bill Ryan and I am with Morgan
22 Stanley as an executive director in our legal and
23 compliance function. I am here today to speak on
24 behalf of SIFMA. We collectively appreciate the
25 ability and opportunity to testify before you today.

1 We obviously appreciate the Department's
2 investment advice initiatives and the time and care
3 that you've put into them, and we support the
4 Department's decision to hold a hearing to discuss some
5 of the issues that have been raised in both the comment
6 letters and in the notice period.
7 We strongly support the proposed regulation
8 and class exemption and we commend the Department for
9 the work that they've done. We think that the
10 regulation and the exemption have been subject to a
11 thorough process of evaluation and examination, and
12 that examination precedes the entire period of the PPA,
13 going back, as some commentators would note, to the
14 1990s. We believe that the Department faithfully and
15 closely interpreted the statutory requirements in the
16 proposed regulation.
17 At the same time, I think it's clear to say
18 that SIFMA believes that we have to recognize that the
19 statutory exemption and the regulations, as laudable as
20 they are, have some intrinsic limitations that limit
21 and make them less helpful to plan participants, and as
22 has been noted by some commentators, IRA participants.
23 The class exemption, we believe, is a
24 necessary step that will lead to better decision making
25 and enhance retirement security for millions of

1 individuals. We are concerned that without the class
2 exemption, millions of Americans who are worried about
3 their retirement security simply won't have advice
4 available to them at all.
5 Unfortunately, and I think it's safe to say,
6 that Morgan Stanley and SIFMA have gone through this
7 and experienced at close quarters the turmoil of the
8 regulatory market and the financial markets over the
9 last few months.
10 We think, collectively and individually, as
11 part of this situation that this provides a graphic
12 illustration of the pressing need for participants in
13 401(k) plans and in IRAs to receive meaningful, prompt,
14 and individualized advice. Candidly, our experience
15 has been, and we believe this to be true of the members
16 of SIFMA, that in call centers, in questions, in
17 comments, it's clear that retirees and workers are
18 terrified, candidly, of market uncertainties. They're
19 worried about their retirement savings and they need,
20 they want, and they keep asking us for, specific
21 guidance and specific direction.
22 We believe that there's really no simple or
23 effective way to try to deliver this kind of advice to
24 the majority of American workers, as we believe others
25 have noted, and the difficulty in trying to expand the

1 model of individualized advice to more Americans,
2 unless you deal not only with the independent market,
3 but also try to work through distribution models that
4 are in effect and are present in the American
5 communities. We are talking about the registered
6 advisors, we're talking about brokers, insurance
7 agents, and other established delivery markets.
8 We believe that the current system is only
9 working for those who actually can afford a fee-based
10 advisor or those with the confidence, candidly, or the
11 experience to rely on computer modeling and then tailor
12 their own individual objectives using those pieces of
13 advice.
14 We strongly believe that the best and,
15 candidly, most stabilizing of those--and this has
16 certainly been our experience--is one-on-one, person-
17 to-person contact, especially in times of financial
18 turmoil or uncertainty. We obviously understand that
19 there are those who claim that if advice is given by
20 advisors with ties to the products that they sell or
21 with ties to large financial institutions, the advice
22 will never be in the interests of plan participants or
23 beneficiaries. We believe these issues and these views
24 are mistaken and misunderstand our delivery product
25 systems. Candidly, we don't think, especially given

1 the circumstances, that we can allow unfulfilled demand
2 in the area of investment advice to continue.
3 In my remarks on behalf of SIFMA today, I will
4 focus primarily on the need for the safeguards provided
5 in the class exemption, how we believe the class
6 exemption will have a positive impact on the quality of
7 advice, not merely the availability, and the number of
8 people receiving it, and briefly discuss some of the
9 contentions with respect to the Department's authority
10 and the PPA fee leveling provisions requiring entity-
11 and affiliate-wide level compensation.
12 We think that the need for more advice and
13 more flexibility to provide advice is well documented,
14 as we believe representatives from DALBAR, the ICI, and
15 others have already testified.
16 In a recent survey of CFOs at large
17 corporations, we found that offering investment advice
18 was ranked as the second most important feature of a
19 401(k) plan, second only to the existence of an
20 employer match. A survey of 401(k) participants by
21 Cigna found that 89 percent of those surveyed--and this
22 is a population of several million--wanted specific
23 recommendations on investment decisions, not
24 generalized advice.
25 Today's advice offerings as they exist have

1 been blessed by the Department over various iterations
2 from the 1990s through now, but they are only used by
3 that 17 percent of the company's workforce. Even where
4 those tools are being used, the statistics indicate
5 that only 39 percent of participants are acting on
6 those recommendations, according to various
7 benchmarking surveys we'd be happy to provide the
8 Department.
9 More effective results, we believe, are seen
10 when the advice can be provided through one-on-one
11 discussions, not merely an interaction of a computer
12 program. With quality advice, contribution rates in
13 these plans increase, savings generally become more
14 diversified, and participants are better prepared for
15 retirement.
16 What we'd like to focus on right now is how we
17 believe that the class exemption benefits both plan
18 participants and IRA holders. First, we think that
19 your exemption clearly identifies the parties that are
20 eligible to give advice. As Jon Breyfogle indicated
21 earlier, the class of individuals that are required for
22 classification under the exemption largely mirror the
23 338 investment managers. These are professionalized
24 investment managers.
25 I would be a liar to say that that necessarily

1 is a guarantee in all cases of a particular financial
2 income, but it is safe to say that those individuals
3 and those entities who are best trained to act in these
4 capacities who are subject to those regulatory
5 requirements are, candidly, better equipped. We think
6 that has even been supported by independent
7 verification from your sister agency, the SEC.
8 In review of pension consultants that the
9 Department and the SEC jointly engaged in in 2006-2007,
10 and these were primarily focused on independent
11 providers of advice, while there was a recognition, for
12 example, of the need to avoid or deal with specific
13 ERISA fiduciary concerns, and candidly intended to
14 avoid them, there was absolutely no appreciation, the
15 Department and the SEC jointly found out, of the
16 responsibilities that those individuals had under other
17 regulatory guidelines, other fiduciary requirements, in
18 particular, the Investment Advisors Act.
19 Second, we think that your exemption provides
20 for significant disclosure and recordkeeping. The ICI
21 previously mentioned that the recordkeeping for your
22 conflict exemptions from the 1970s and the 1980s,
23 especially 86-128, are substantial and we would
24 wholeheartedly agree that this kind of recordkeeping,
25 this kind of disclosure that you're proposing in the

1 exemption clearly exceeds that and is clearly down to
2 the participant level.
3 If there is a proprietary interest in the
4 option that is being described, there has to be
5 disclosure. If the advisor or the affiliate is
6 receiving fees, direct or indirect, there will be
7 disclosure. If there is some type of monetary
8 relationship between the advisor and the option, there
9 will be disclosure.
10 In the case of IRAs, the fact that the fund
11 holder can separately arrange for advice from another
12 advisor that is independent will be disclosed. If the
13 advisor recommends a product with a higher fee, there
14 will be specific disclosure and disclosure of the basis
15 for the recommendation.
16 Candidly, this is much more substantial
17 disclosure than 86-128. It is much more substantial
18 disclosure than the Department has proposed in other
19 contexts, and we understand that that is one of the
20 rules of the road and that is something that can, in
21 fact, be clearly judged not only by plans and
22 participants and by the Department upon review, but
23 clearly by the auditing process.
24 Third, and I think it's important to emphasize
25 this, the advisor will affirmatively accept ERISA

1 fiduciary status. This is not a situation where, if
2 you're providing advice that might be incidental to the
3 transaction in a brokerage context, that the broker or
4 the other parties involved will not be understanding
5 and aware that they have 404 responsibilities; clearly,
6 we acknowledge them. If the exemption stands, we would
7 abide by them.
8 Candidly, we would be, and expect to be,
9 judged by them, not merely in performance of the
10 exemption and not merely in monitoring the performance
11 and the fee leveling and other disclosure requirements,
12 but the level of advice and the quality of advice we'd
13 be providing.
14 Fourth, the class exemption requires that the
15 advice be non-discretionary. In other words, in all
16 cases the participants will have to take the initiative
17 to implement the advice. While we understand that that
18 may not be the preferred model at different points in
19 the retirement plans, it reflects the reality that the
20 majority of plans today are defined contribution, non-
21 discretionary plans where no investment manager is
22 hired. We are not trying to redo or undo history.
23 Fifth, the class exemption requires an
24 evaluation through an independent audit process that
25 the advice is objective and the disclosure is clear and

1 adequate. The audit requirement will mean, in effect,
2 that there will be two levels of oversight. I can
3 clearly attest to it from my own organization.
4 First, firms that offered investment advice,
5 that affirmatively decide to undergo and modify their
6 programs to adopt this exemption, will have to have
7 internal control procedures that I can tell you will be
8 tested both by our internal auditing function with
9 respect to fee disclosure and fee leveling, as well as
10 our internal compliance departments. There has to be,
11 and there will be in these institutions, internal
12 review to ensure compliance.
13 Then on top of that, the firm has to permit an
14 independent auditor to evaluate and review the advice
15 and the internal controls. We think this is a very
16 significant requirement and will likely, candidly,
17 increase the expense to us of providing the advice, but
18 this is an expense that we are willing to bear. We
19 think that critics of the exemption have dismissed this
20 requirement, unfortunately, too hastily, while
21 accepting on its face perhaps that computer models are
22 inherently objective.
23 Sixth, the class exemption does provide for a
24 fee leveling alternative. We think this is an
25 important safeguard as well. Eliminating potential

1 advisor bias can clearly be helpful and is used in many
2 firms today. However, the class exemption requires
3 that a level fee requirement does not apply itself in
4 the context of an IRA account holder.
5 As SIFMA testified previously, the IRA account
6 holder who is near retirement age may be looking at
7 multiple types of investments and it is impossible for
8 a diversified financial services firm offering a wide
9 range of investments to levelize fees at the entity
10 level without totally changing the business structure.
11 Some may respond that that kind of change is
12 absolutely to be required and, candidly, to be mandated
13 by the Department that all advisors have to be entirely
14 fee-based. We don't think, necessarily, that that's
15 appropriate, for obvious reasons. But we also think it
16 does violence to the nature and understanding, as we
17 understood it, of the ERISA regulatory requirements and
18 the legislative history. We are referring not
19 necessarily to the statements that were made, but the
20 ERISA conference report.
21 In the grant of authority that the Department
22 has with respect to exemptive relief under 408(a), the
23 Department clearly has full authority to issue a class
24 or individual exemption whenever it determines it has
25 already been discussed and you have determined it is

1 administratively feasible, in the interest of
2 participants, and protective of their interests.
3 Nowhere in the grant of authority, either in
4 1974, in the PPA or otherwise, was the Department told
5 it could not grant an exemption unless the terms of the
6 exemption provided identical terms and conditions of a
7 similar statutory exemption. In fact, the '74
8 conference report in particular stated that, "The
9 conferees recognized that some transactions which are
10 prohibited and for which there are no statutory
11 exemptions nevertheless should be allowed in order not
12 to disrupt the established business practices of
13 financial institutions."
14 We think that the Department quite wisely
15 recognized that while independent advisors are clearly
16 a benefit to participants who can either afford them or
17 who have access to them, there is a distribution model
18 for investment advice that already exists that should
19 be utilized, and it should be utilized under a
20 controlled vein so that the Department is convinced
21 that it is in the best interests of plan and IRA
22 beneficiaries.
23 We also think, candidly, that without
24 utilizing this type of distribution system, systems
25 that we have built, that our insurance brethren have

1 built, and others, we don't believe that millions of
2 workers will have access to this kind of individual
3 advice on a strictly fee-for-service basis alone from
4 an advisory basis.
5 As an example of this, and it's probably not
6 representative but I will offer it for what it is, we
7 searched the database of the National Association of
8 Personal Financial Advisors, which is an entirely fee-
9 based organization with specific accreditation
10 standards, to try to locate an advisor in Iowa.
11 We located 13 advisors in the entire State of
12 over 700,000 people. We would submit, and we suspect,
13 that even the hardest-working independent advisors in
14 the current context could not begin to meet the demand
15 for guidance from those participants who are reaching
16 retirement age and who do not have significant
17 retirement savings for a fee-only advisor.
18 Finally, and I think I've touched on this
19 point, we ought not to forget, and we're certainly not,
20 that there will be significant costs imposed on the
21 fiduciary advisor and the affiliated group if there's a
22 failure to follow these requirements. We are clearly
23 subject to the 404 requirements for fiduciary status of
24 the advice. It has to be worthy of an ERISA fiduciary.
25 But in plain fact, if we do not adhere to the

1 terms of the exemption, we have a prohibited
2 transaction. It results in the reversal of the
3 investment transactions, the plan or the IRA is
4 required to be made whole for any losses, we are
5 required to pay a substantial excise tax, we are
6 potentially subject to civil liability under 502, and
7 theoretically, if you believe there is a pattern or
8 practice, the Department, in its discretion, could
9 certainly find us liable under 501.
10 These significant costs and the potential for
11 liabilities for non-compliance, candidly, are powerful
12 incentives for us not only to pay attention to these
13 rules, but to try to get them right and make sure that
14 our advisors comply with these requirements.
15 Now, just briefly, let me touch on the
16 statutory exemption and the fee leveling rule
17 applicable under the PPA. I've already touched a bit
18 on this.
19 Some critics of the proposed regulation
20 suggest that the regulation goes beyond the scope of
21 the statute by requiring only the advisor and the
22 employee agent to have level fees and not extending the
23 fee leveling requirement to all affiliates. We don't
24 believe that's true. Nowhere in the statute or the
25 legislative history--which I think it's safe to say was

1 not overwhelming in terms of the PPA--did Congress
2 mandate that all affiliated companies be level as well.
3 Indeed, we believe such a provision would have
4 made no sense, as I believe you have observed and as
5 others have observed already, because if there are no
6 fee differences at all there would be no prohibited
7 transaction.
8 Again, going down the fee leveling road, and
9 the ICI in particular has touched on this, there are a
10 number of exemptions that deal with fiduciary conflicts
11 where the Department has decided that fee leveling is
12 either not required on an entity level or more limited.
13 If Congress believes, in the PPA or subsequently, that
14 these prior exemptions were not protective of plans and
15 participants, they have ample opportunity to provide
16 oversight and make that clear.
17 In addition, as you noted, the Department
18 first issued its interpretation of the fee leveling
19 requirements for the PPA in 2007. We are not aware,
20 and SIFMA is not aware, of any letters or formal
21 guidance objecting to this and we believe that it is
22 possible that there are a number of participants and
23 advisors who are, in fact, relying on this today.
24 In our view, the proposed class exemption, we
25 believe, carefully balances the need to broadly

1 disseminate investment advice in a practical way to
2 millions of participants in a manner that will be
3 useful, while at the same time imposing controls on us
4 that will be protective of participants and IRA owners,
5 will make conflicts transparent to those individuals so
6 they can assess this advice dispassionately. We do not
7 think that this was an easy job and we commend the
8 Department for striking what we believe is the right
9 balance.
10 We think you have crafted a careful set of
11 rules that will help in more widespread delivery of
12 advice to participants, while protecting them against
13 conflicts and self-dealing. It relies heavily on clear
14 disclosure, it's grounded in the prudence rules of 404,
15 and given the fact that ERISA was drafted, candidly, to
16 prohibit all transactions and all conflicts unless
17 otherwise exempted by the Department or by the statute,
18 we believe that this is an appropriate exemption and we
19 urge the Department to finalize the rules promptly.
20 We thank you again for allowing us to testify.
21 SECRETARY CAMPBELL: In your testimony, you
22 mentioned that the in-plan annuity investment option
23 shouldn't be modeled by the computer model. Could you
24 expand on why that is?
25 MR. RYAN: Well, I think our concern--and

1 we've touched on some of these issues with annuities
2 and the target funds and with other similar type of
3 pool vehicles--is that many variable annuities are both
4 an accumulation model as well as a distribution model.
5 If you have a variable annuity that has multiple
6 investment options, candidly, it looks like a mini-plan
7 and it is very difficult at times to classify that what
8 that variable annuity is according to the normal asset
9 allocation modeling classifications: is it a large cap
10 equity? Is it a debt instrument? Is it something
11 along those lines?
12 We think the issue is really one of difficulty
13 in classification based on the nature of the
14 investments. We agree that they need to be included
15 and referenced as part of the overall profile and
16 overall options for a plan sponsor, and candidly for an
17 IRA holder.
18 We don't suggest that they should be excluded,
19 but we would urge the Department to understand that
20 some of these investments are more easy to classify in
21 particular asset buckets than others. We think that
22 variable annuities fall into that category; target
23 funds, target mutual funds, also fall into that
24 category.
25 We actually think employer securities -- or

1 let me say I think employer securities are relatively
2 straightforward, but difficult for obvious reasons in
3 an employment context. There are other variables in
4 the employment security issue that need to be
5 considered, primarily the tax considerations,
6 distributions for net unrealized appreciation and the
7 like.
8 All we're saying is that the models may not
9 perfectly reflect the variables that are inherent in
10 some of these products, and candidly it's one of the
11 reasons why we believe that you may need an individual
12 to explain them as well.
13 DEPUTY ASSISTANT SECRETARY LEBOWITZ: In your
14 presentation to us a few minutes ago, you were kind of
15 ticking off the protections in the class exemption and
16 you cited the pattern and practice provision.
17 MR. RYAN: Yes. Well, I figured I should
18 bring it up, because I figured you would ask about it.
19 DEPUTY ASSISTANT SECRETARY LEBOWITZ: Well, I
20 just note in your written testimony that this is a
21 provision that SIFMA strongly objects to. In fact, you
22 describe it as "punitive", which I wouldn't argue with
23 that characterization. I think that's what it's
24 supposed to be. Perhaps you could --
25 MR. RYAN: I think our objection to it is

1 similar to the ICI objection, in that, number one,
2 we're not entirely sure what a "pattern or practice"
3 means. It has different connotations under different
4 sets of laws. We think, clearly, if the Department is
5 looking to -- we do think, and we would agree, that in
6 situations where an exemption has worked and has been
7 adequately provided by a particular fiduciary advisor
8 for 250 participants and it's not working for 25, that
9 if 25 is found by the Department to be sufficient as a
10 pattern or practice, we would argue that that shouldn't
11 necessarily go to the notion of invalidating the prior
12 advice or the prior compliance with the 250.
13 I think we would also suggest that the
14 Department probably has a number of different ways, as
15 my grandmother used to put it, to skin this cat, not
16 merely trying to identify specific conduct of pattern
17 or practice, which I suspect will be difficult to do in
18 an exemptive process, and you will have a number of
19 people keep asking how many times is a violation a
20 pattern, or how does that tie into the voluntary
21 fiduciary correction program of trying to do this on a
22 group basis. If it's enough for a group, does that
23 mean it's a pattern for these purposes?
24 MR. RYAN: I think our point is that if we
25 don't follow the terms of the exemption, we are clearly

1 going to be penalized on the terms of any particular
2 transaction. If the Department can--and I think it
3 can--make this finding independent of the exemptive
4 process, if the Department, in its investigatory
5 capacity determines that they've received sufficient
6 complaints about any particular fiduciary advisory,
7 Morgan Stanley or anyone else, the Department is
8 perfectly capable under existing law to basically
9 withdraw the exemption as it applies to Morgan Stanley
10 prospectively. I think our concern is necessarily
11 retroactively penalizing entities where it's not clear
12 what the pattern would be or whether --
13 DEPUTY ASSISTANT SECRETARY LEBOWITZ: That's a
14 whole other proceeding, though, isn't it, if we could
15 do it? I would defer to our legal counsel on that.
16 MR. RYAN: Well, I would certainly defer to
17 Mr. Taylor on this, but I think our concern --
18 candidly, we are always impressed by the Department of
19 Labor's investigatory capacity. We think you actually
20 have full investigatory authority to look at how we're
21 acting at particular times. But we think the standard
22 that you're proposing in the exemption is, candidly,
23 difficult for us to understand what is meant. I think
24 that is part of what we've got here. We also think,
25 candidly, you have the authority to penalize us outside

1 of it.

2 DEPUTY ASSISTANT SECRETARY LEBOWITZ: I
3 appreciate the point you've made. Clearly, we have the
4 authority to conduct investigations to determine
5 compliance and we have a variety of different tools
6 available to us in the enforcement context, including
7 seeking injunctions and other kinds of actions. Those
8 are of a different sort, though, and are somewhat more
9 difficult to achieve, particularly when we're seeing
10 what we believe is an entity that might essentially be
11 contemptuous of the rules.

12 Absent some kind of pattern and practice
13 provision, we're left with having to determine plan by
14 plan, participant by participant, advice by advice or
15 provision of advice by provision of advice whether or
16 not there's a violation. That went back to my little
17 back-and-forth with Jon. That strikes me as not
18 terribly feasible in the sense that we think about
19 feasibility as the statute describes it.

20 MR. RYAN: Well, perhaps I could throw an
21 alternative model, or at least a concept. We certainly
22 didn't discuss this in our exemption. But the
23 Department, at different points, has revoked exemptions
24 for various individuals, primarily statutory authority,
25 I think, starting with the QPAM exemption, with the

1 conviction of E.F. Hutton and various entities that
2 merged into E.F. Hutton and inadvertently lost their
3 QPAM status.
4 Different analogy. I think part of the
5 reasoning behind the Department's allowing those
6 entities to continue managing money was that the
7 ongoing entity was not involved with any particular
8 offense. I think if the Department is not fully
9 comfortable with its ability to investigate or monitor,
10 and candidly our experience has been that if our
11 clients don't like what we're doing they are very
12 comfortable in calling the regional office of the
13 Department of Labor to ask their assistance on any
14 particular issue.
15 But if the Department thinks that they need to
16 do something with respect to this and get that kind of
17 authority, which we would agree is unusual and actually
18 unprecedented, what we would strongly suggest is that
19 the Department give us some indication of what, in its
20 mind, it thinks is a pattern or practice. If it's two
21 or more situations, I will tell you that virtually all
22 providers will have a pattern or practice.
23 If it's some sort of proportional argument or
24 some sort of -- I appreciate the difficulty of
25 grappling with the definition, but at the same time I

1 think in order to operate we actually need to know the
2 risks we're taking on, not merely the fiduciary risks,
3 but honestly the prohibited transaction ones as well.
4 DEPUTY ASSISTANT SECRETARY LEBOWITZ: Well, if
5 you have any ideas along those lines, feel free to
6 submit them to us.
7 MR. RYAN: We will be more than happy to.
8 DEPUTY ASSISTANT SECRETARY LEBOWITZ: Thank
9 you.
10 MR. TAYLOR: You said earlier on that you
11 believed that the people who testified against fee
12 based advice misunderstand the protections that are
13 already in place outside of ERISA. I was wondering,
14 without asking for too long an explanation, what do you
15 think are the key protections outside of ERISA that
16 keep fee-based advisors from steering people to --
17 MR. RYAN: I think it depends on the
18 distribution model that we are talking about. To the
19 degree that you were talking about a brokerage-based
20 model, you were talking about the FINRA suitability
21 requirements, the fact that FINRA, candidly, is in our
22 branches on a constant basis and of those of our
23 members.
24 If you're talking in the insurance regulatory
25 environment, you clearly have insurance regulators in

1 each one of the States monitoring the sales practices
2 that go on with respect to both the self-reported
3 insurance sales practices, as well as other issues as
4 part of their ongoing due diligence. I think it's safe
5 to say that certain States are more known for being
6 more aggressive in these areas, but it's clear that
7 even in the insurance regulatory scheme that is a
8 fairly universal regulatory check.
9 Certainly to the degree that you are a dual-
10 registered broker-dealer or you have an investment
11 advisory unit, you clearly have the SEC and the SEC's
12 investment advisory requirements and the reviews that
13 the SEC does. Now, if you're fortunate enough to be a
14 bank holding company, which Morgan Stanley is, we
15 certainly have the Federal Reserve in our offices on a
16 constant basis, looking out for account information for
17 clients, not specifically, obviously, focused on the
18 broker-dealer side. I think it's safe to say that we
19 think there are other regulatory protections. We also
20 think that we have self-reporting disclosure
21 obligations not merely under ERISA, but under FINRA,
22 under the various State insurance requirements to the
23 degree they're applicable.
24 Candidly, many of the scandals that were
25 articulated--not all, obviously, but many of them--

1 were, in fact, self-reported, or at least started to be
2 self-reported by different members. We are not arguing
3 that we are perfect. We are arguing, however, we are
4 regulated.
5 MR. DOYLE: A couple of questions. First,
6 following up on Mr. Silvers' testimony, that
7 essentially--at least I think his proposition was--
8 cross-selling and directing investments --
9 MR. RYAN: Are the sole reasons.
10 MR. DOYLE: -- the steering.
11 MR. RYAN: Right.
12 MR. DOYLE: -- is essentially the basis--the
13 only basis--on which you can offer investment advice
14 economically feasible for plans. I was just curious
15 whether you'd like to address that issue.
16 MR. RYAN: I think there are clear economic
17 costs in offering any one of these programs. I think,
18 candidly, it's safe to say that programs can be offered
19 by our members better when they are scalable, so that
20 to the degree that you are in the position of actually
21 establishing -- let's just say for the sake of argument
22 the exemption is adopted. We and others will literally
23 look and probably focus on our advisory programs, look
24 at how they are structured because they already have
25 built-in infrastructure and architecture, and then try

1 to adapt those as suitable investment offerings, to the
2 degree they're not already, for IRAs and for 401(k)
3 plans.
4 We think they can if there is a revenue stream
5 that is built in to the advice that the advisor is
6 allowed to collect, that the firms are not penalized by
7 having affiliates receive other types of fees in
8 connection with the products or services. I will tell
9 you that one of our concerns historically has been that
10 in offering, we're acting as a fiduciary advisor for a
11 particular retail client.
12 We've been concerned periodically as to
13 whether or not that implicated institutional trading
14 revenues that we might have received with respect to
15 brokerage commissions that the institutional money
16 funds may, in fact, be directing through another branch
17 of the company. We have trouble figuring out at
18 different points where the fee leveling begins and
19 ends.
20 But I think it's safe to say that if you're
21 scaling a model that requires you to provide one-on-one
22 individual advice, it can be very expensive. If you're
23 scaling a product that actually offers a competing
24 track of computerized model plus individualized
25 recommendations, candidly, we have those products. We

1 do scale them. We actually scale them fairly well in a
2 competitive process outside of the ERISA environment,
3 we and other broker-dealers.
4 MR. DOYLE: And do you have protection that
5 applies to minimize the likelihood of steering and --
6 MR. RYAN: Absolutely. Depending on the type
7 of program, we have some programs that are specifically
8 non-proprietary. Some, if they mix proprietary and
9 non-proprietary products, have fee offsets with respect
10 to those from an appearance perspective, candidly, as
11 much as anything else under the advisory rules. We
12 think we can follow those. We think we also can
13 disclose this. We are modeled in many of these
14 programs, candidly, to disclose conflicts. That is one
15 of the requirements under the Advisors Act.
16 What we would expect, candidly, is looking at
17 the requirements of the exemption, our advisory
18 conflict disclosure will be considerably enhanced in
19 the ERISA context, but we have something to work with.
20 So I think we do have frameworks that will actually
21 protect participants. Anecdotally--and I only offer
22 this as anecdotally--I think it's safe to say that when
23 our clients look and our financial advisors look at our
24 various product offerings, our advisory platforms are
25 open-architecture brokerage arrangements.

1 While it's safe to say that everyone is aware
2 -- Van Campen in Morgan Stanley is a Morgan Stanley
3 fund and Morgan Stanley, it's also safe to say that our
4 advisors are very cautious about pushing or being
5 perceived to push any products, that we have fee offset
6 arrangements that we've designed to independently
7 evolve this. Candidly, most clients want to look at
8 all the ranges of products, but if they're offering the
9 entire range of proprietary and non-proprietary, our
10 evidence does not indicate in any way, shape or form
11 that we're steering them toward products.
12 MR. DOYLE: One other question. I think one
13 of the suggestions, and it may have been Mr. Carmody in
14 his testimony -- with regard to, we have a requirement
15 as part of the disclosures that material contractual
16 relationships be disclosed. I think the recommendation
17 or suggestion was along the lines of attributing some
18 percentage or dollar amount to that relationship. Just
19 a question as to is that feasible, is that complicated?
20 MR. RYAN: It's complicated. I won't say that
21 it's impossible, because arguably nothing is
22 impossible. But given the range of our organization, I
23 could tell you for certain types of service providers
24 that straddle accounting professionals, recordkeepers,
25 and the like, what a gross revenue might be for the

1 firm, but the firm is comprised of an institutional
2 broker-dealer, a retail broker-dealer, an asset
3 management unit, and an international brokerage unit,
4 now a bank.
5 Well, we don't get into that too much. But
6 that would be difficult to parse out -- while I could
7 do it on an aggregate basis, candidly, it wouldn't look
8 at all material. I'm not sure really that's what the
9 Department is getting at. I think you may want to
10 note, in the context of a particular program or
11 service, how much we're paying a service provider. I'm
12 not sure. I think we will have difficulty trying to
13 extrapolate it across an enterprise. I think that will
14 be very difficult.
15 MR. DOYLE: Well, if you have any further
16 thoughts on that, I think we'd appreciate hearing
17 those.
18 MR. RYAN: We'd be happy to do that.
19 MR. PIACENTINI: One of the themes we've
20 touched on several times here has been to what degree
21 flat fee advice is or is not adequately available. In
22 your testimony, you gave an example where you said that
23 you were able to identify only a handful of flat-fee
24 advisors in the State of Iowa.
25 MR. RYAN: Thirteen advisors. Yes.

1 MR. PIACENTINI: And presumably there are lots
2 of DC plan participants, lots of IRA holders, folks who
3 could use advice. So my question is, why do you think
4 that is? If the regulatory enforcement has made it
5 hard to offer anything other than flat fee advice
6 historically, if there are lots of people who need
7 advice, would like to have advice, why hasn't that
8 market become more robust?
9 MR. RYAN: My own take--and it is clearly my
10 own take and it's not the position of SIFMA and Morgan
11 Stanley--is that it's expensive. My experience has
12 been, in the context of a 401(k) plan, anytime you have
13 an individual line charge or some sort of payment that
14 is going out with respect to a particular service
15 provider or advisor or what have you, that candidly
16 very few people want to pay for it.
17 Employers, by and large, are worried about the
18 fiduciary liability with respect to the selection,
19 there's no doubt. But they also don't want to pay for
20 it, either. In many cases, what they're doing is
21 they're having enough trouble trying to make the
22 contributions to the plans, especially on a matching
23 basis. So I believe that one of the reasons it hasn't
24 developed more is primarily economics.
25 I think there are some scaling issues that you

1 have with an individual advisor and how many people can
2 they service without a large organization behind them.
3 I think there are clearly economies of scale that a
4 Morgan Stanley branch has that an individual branch or
5 one or two independent fee advisors would not.
6 MR. PIACENTINI: But couldn't you have a
7 larger, more scaled flat fee advisor entity?
8 MR. RYAN: I think it's theoretically
9 possible, surely. I don't think there's anything that
10 precludes that development, I just have not seen it. I
11 think it's economic.
12 MR. PIACENTINI: Okay. And your assessment
13 that it's economic, it might not be affordable in the
14 DC plan market, you'd have a similar analysis for the
15 IRA market?
16 MR. RYAN: Yes. Again, there is availability
17 of this type of service. I think, as others noted in
18 particular, you may have the large balance IRAs
19 availing themselves of those.
20 MR. PIACENTINI: Right.
21 MR. RYAN: But these do not tend to be cheap
22 services.
23 MR. PIACENTINI: Right. So then I guess my
24 follow-on question is, why is it -- you said scaling.
25 Is there any other reason why the services would cost

1 less? I mean, I understand there might be less of a
2 direct charge if there is another revenue source, but
3 why might they cost less?
4 MR. RYAN: I think it's really more of a
5 direct charge issue, candidly. I think on some levels,
6 when you have a large organization and you are in fact
7 doing research or you have access to various types of
8 information that you could put out or models that you
9 could pay for, if I spend $100,000, for example, on a
10 MorningStar asset allocation model and I spread it out
11 among 700 branches among Morgan Stanley as opposed to
12 one or two advisors, you may have the same kind of
13 costs but it's much more diluted in terms of the cost
14 that actually needs to be charged to the individual
15 provider.
16 MR. PIACENTINI: I think I'm hearing two
17 separate points. Let me try to clarify them both. One
18 point has to do with dilution or spreading costs.
19 MR. RYAN: Right.
20 MR. PIACENTINI: Which certainly are pertinent
21 to a computer model.
22 MR. RYAN: Right.
23 MR. PIACENTINI: But the other had to do with
24 whether the charge is direct or not. So leaving the
25 computer model aside and talking about individualized

1 advice, would that be more available than flat fee
2 individualized advice? If so, would that cost less?
3 If the answer is, well, the direct charge would be less
4 because there are other revenue sources, then don't
5 those other revenue sources, nonetheless, find their
6 way back to the account holder?
7 MR. RYAN: Well, I think it depends. You
8 clearly have the issue on direct versus indirect
9 charges, and part of this would have to be cured by
10 disclosure, which the Department is mandating.
11 MR. PIACENTINI: Right.
12 MR. RYAN: To the degree that you have various
13 types of fee services that are in pooled funds -- for
14 example, in the mutual fund context. The ICI has
15 already described how their charges are required by
16 law, they are disclosed. There are issues with respect
17 to some portion of those, but by and large you know
18 what those payments are and you know if you're holding
19 those mutual funds in a particular brokerage or
20 custodial environment, somebody is paying for
21 recordkeeping.
22 Nine times out of 10, it is not going to be
23 the mutual fund complex at all. So in the individual
24 context, it's not quite the same thing to say, if I'm
25 selling an individual stock or bond you have a

1 commission schedule. The only differential we might
2 have is whether or not it's agency or principal, things
3 along those lines. You can have structured products
4 and other types of debt obligations that are more
5 complicated, but at the same time I think it's safe to
6 say that those kinds of products, generally speaking,
7 have disclosure documents that disclose what the
8 compensation is and what the firm, generally speaking,
9 earns in offering them.
10 So I think, to your point, the direct charge
11 may be less if you have indirect revenues. Candidly,
12 there is no question about it, if you sell a structured
13 note product it will in fact be profitable to Morgan
14 Stanley if it is in fact sold to a brokerage statement.
15 But it's also disclosed as to what Morgan Stanley has
16 actually earned in the offering document.
17 MR. PIACENTINI: So from the perspective of,
18 say, the IRA holder, I can see what the flat fee advice
19 would cost, and maybe if I think that's too expensive I
20 can see some direct charge, perhaps, or not for advice
21 I would get where there's another revenue source
22 available to pay for that advice. So at the end of the
23 day, does that mean that the latter costs me less or
24 that just the direct charge is less, and I may or may
25 not realize that it costs me about the same?

1 MR. RYAN: Well, I think the truth is, it
2 depends on the way you're looking at it from an
3 economic perspective. If I'm looking at it from the
4 plan participant or IRA perspective, I would probably
5 say the latter situation costs me less because there's
6 less of a direct charge. This is part of what the
7 Department was getting into in terms of making sure
8 that there was adequate disclosure of these types of
9 pooled fee arrangements back and forth so that
10 participants were aware.
11 But human nature is such that if you see an
12 actual charge in an account, you tend to focus on what
13 that charge actually is. You may understand that there
14 may be other revenues that are being generated, and you
15 should know this, it should be disclosed, but I think
16 without a study, I think human nature would lead me to
17 think that people care about those indirect charges
18 less.
19 MR. PIACENTINI: So even if it costs about the
20 same, I'm more likely to buy it if I'm paying
21 indirectly.
22 MR. RYAN: Yes. That would be my view.
23 MR. PIACENTINI: Thanks.
24 DEPUTY ASSISTANT SECRETARY LEBOWITZ: Thank
25 you.

1 MR. RYAN: Thank you very much.
2 DEPUTY ASSISTANT SECRETARY LEBOWITZ: Marcia
3 Wagner is our next witness.
4
5
6 **THE WAGNER LAW GROUP**
7 **By Marcia S. Wagner, Esq.**
8 MS. WAGNER: Good morning. Thank you for
9 having me here. It's really a pleasure. I'm honored
10 to be here. It's a pleasure.
11 I am the name partner. I'm going to be
12 reading from testimony, by the way, which if you want
13 I'm happy to submit in non-scratched on form to this
14 committee.
15 I am the name partner and founder of the
16 Wagner Law Group, a law firm of 14 attorneys which
17 specializes in ERISA and employee benefits. The
18 continued success of my firm and my livelihood for the
19 next 20--and the way the market is going, probably 30--
20 years depends on a healthy, private retirement and
21 pension benefit system.
22 This very long-term perspective, in contrast
23 to that of many executives of financial service firms
24 and many political appointees, leads to my deep concern
25 that the proposed class exemption would not be helpful

1 and that it could lead to substantial abuses and
2 reduced returns that could reduce confidence in amounts
3 contributed to plans and to IRAs over the long term.
4 In essence, the basic issue is that the
5 proposed exemption, by allowing for variable fees for
6 entities closely affiliated with fiduciary advisors,
7 even their very employers, is permitting self-dealing
8 without sufficient productive conditions.
9 I respectfully, however, propose a very simple
10 solution that helps obviate or mitigate against this
11 problem. First, I would like to talk, if I could,
12 about differences in perspective. Recent events
13 demonstrate, frankly, the short-term perspective of
14 senior executives at many financial service firms.
15 They were willing to pursue short-term profits, even
16 when it meant putting the very survival of their own
17 firms, even the global economy, at risk.
18 There are many reasons for this. Among them,
19 the average tenure of these executives is low, as well
20 as how they are compensated. I am dubious that the
21 recent bail-out has reformed their views.
22 Evidence of this will be testimony that you
23 will hear, have heard, or have received from those very
24 firms in support of this class exemption, despite the
25 knowledge of some, or perhaps all of them, concerning

1 what I, upon information and belief, understand were
2 the very negative consequences for IRAs with respect to
3 the most similar class exemption, PTE-86-128.
4 As you know, Section 408(a) of ERISA requires
5 the Department to make findings prior to granting an
6 exemption. With all due respect, the record does not
7 support granting an exemption such as the one the
8 Department has proposed, based on two standards which I
9 will discuss.
10 The first is in the interest of the plan and
11 protective of the rights of P&Bs, participants and
12 beneficiaries. None of the studies of which I am aware
13 in any way support the idea that disclosure of self-
14 dealing sufficiently mitigates the negative effects to
15 result in a net positive for clients who are impacted
16 by self-dealing. There is, however, the fact of
17 disclosure-based self-dealing. The evidence is the --
18 in accounts, particularly IRAs under PTE-86-128, were
19 adversely impacted.
20 Again, with due respect, the failure of the
21 Department to examine this evidence or even avail
22 itself of it, despite having 20 years to do so, calls
23 into question its analysis of the effect of granting
24 this exemption.
25 Another point. The Department should take

1 note of the lobbying activities of the financial
2 service providers to reduce the enforcement and the
3 effect of the excess tax under 4975 of the Internal
4 Revenue Code of 1986, as amended. On information and
5 belief, a massive and expensive lobbying effort was
6 undertaken under PPA to effectuate 4975(d)(23), despite
7 the fact that the IRS doesn't really make much of a
8 significant effort at all in collecting taxes under
9 4975, given the amazing volume of transaction involving
10 IRAs and similar plans.
11 Therefore, the reason for this lobbying effort
12 must have been the potential for large liabilities if
13 the IRS ever did engage in a meaningful enforcement of
14 the tax because of the abuse of tax-favored retirement
15 vehicles, particularly IRAs, which are protected
16 against abuse only in general by the enforcement of
17 such excise tax.
18 Furthermore, if the results under 86-128 were
19 positive for plans and for IRAs, those in the
20 possession of this data would have most assuredly made
21 it publicly available to demonstrate the efficacy of
22 what they were doing with self-dealing.
23 We surmise that the reason they failed to do
24 so is that the results were negative and publication of
25 such results would not be helpful. Thus, while the

1 available evidence may support a finding that the
2 proposed exemption would not be in the interest and
3 protective of the rights of participants and
4 beneficiaries, it is very questionable whether the
5 evidence would support a finding that the proposed
6 exemption would be in the interest of participants and
7 beneficiaries absent a new protection, which I will
8 discuss in very short order.
9 Let's talk about administrative feasibility,
10 the second condition under 408(a). There are a number
11 of elements of this proposed class exemption which are
12 not administratively feasible in that they cannot be
13 effectively monitored. For purposes of this testimony,
14 I will focus on two of them. The first, is the
15 condition that a fiduciary advisor may not advise
16 investing in investment options of the same class that
17 generate larger fees for the advisor or certain related
18 parties absent a finding that such advisor prudently
19 concluded that the recommendation is in the best
20 interests of participants and beneficiaries.
21 The fiduciary must engage an auditor to
22 determine whether it has complied with the conditions
23 of this exemption. It is difficult to see how an
24 auditor could determine whether such recommendation was
25 prudently determined in a manner that is

1 administratively feasible, given the complexity under
2 the Department's and the court's interpretations of
3 determining prudence involving self-dealing,
4 particularly in the very unique and fact-intensive
5 circumstances, by the way, concerning IRAs.
6 Also, given this complexity, the vast majority
7 of violations of this condition, I believe, would
8 either not be detected or a remedy would not
9 effectively exist given the cost of proving the
10 violation.
11 The second issue is the condition that
12 anything of value received by specified persons
13 providing investment advice cannot vary depending on
14 the investment options selected by the participant,
15 beneficiary, and or alternate payee. There are many
16 ways a specified person can be incentivized, which
17 would be difficult, if not, frankly, impossible to
18 monitor: promotions, perks, good leads to brokers,
19 keeping a job, et cetera. Frankly, it burdens my
20 imagination as to how this condition could be
21 effectively monitored in any administratively feasible
22 manner.
23 A solution to vague and unenforceable
24 conditions would be to require evidence of what the
25 Department wishes to conclude, that the exemption would

1 be in the interest of participants and beneficiaries.
2 A very direct way to do this is to compare the returns
3 of accounts receiving advice under the exemption with
4 an objectively determined and appropriate standard,
5 such as those which do not receive advice under the
6 exemption or conditioning exemptive relief on the
7 advice-producing returns solely based on risk not
8 substantially below that of objective, comparable
9 benchmark--for example, a target date index fund or
10 managed account index fund.
11 Such a condition could be easily monitored by
12 an audit and would assure that accounts are not harmed
13 by conflicted advice. Of course the auditor must be
14 given access to all computerized records of
15 transactions for accounts so there could be effective
16 monitoring.
17 I'd like to close saying that if an
18 investigation reveals that IRAs which receive services
19 under 86-128 had very subpar returns and that accounts
20 under this exemption receive similarly bad returns,
21 this exemption would be subject to legal challenge. It
22 could be hard to defend, not having looked into returns
23 of IRAs receiving services for over 20 years, and then
24 provided another disclosure-based exemption without
25 such information.

1 If this exemption is struck down for these
2 reasons, there could be additional fallout. This could
3 add fuel to calls to abolish some of the tax privileges
4 and tax breaks for IRAs and 401(k)s, and frankly would
5 undermine the faith in the government. I urge the
6 Department to avoid these potentialities by adding a
7 reasonable and practical condition such as the one I
8 outlined above.
9 I thank you for taking into consideration my
10 comments.
11 SECRETARY CAMPBELL: I had a question about
12 that. Going to the fee leveling for a second, you were
13 suggesting that basically fee leveling is, in and of
14 itself, an unenforceable standard, if I understood you
15 correctly.
16 MS. WAGNER: No, I don't think I said that.
17 SECRETARY CAMPBELL: Okay. I thought what you
18 said was that you have to ensure that the fees don't
19 vary based on the adoption of the advice provided, but
20 that was something where it would be impossible to
21 determine what constituted a fee, what constituted a
22 benefit.
23 MS. WAGNER: What this testimony is really
24 focusing on is variable fees. It's really the issue of
25 variable fees.

1 SECRETARY CAMPBELL: Okay. Perhaps I
2 misunderstood. I thought when you were discussing the
3 class exemption dealing with fee leveling, that you
4 were mentioning the concern was it would be difficult
5 to --
6 MS. WAGNER: Oh. Yes. I think with respect
7 to that -- I'm sorry. With respect to that, the
8 problem is really, how do you effectively monitor the
9 individual, the employee as not being incentivized in
10 some way to skew advice, in a way? The problem is that
11 there are many factors that can influence how he or she
12 behaves.
13 All I'm saying is, it's a great condition to
14 have. I'm not saying get rid of it. What I'm saying
15 is, you need, perhaps, another condition. I think that
16 there are many ways that an employee, even a level fee
17 employee, can be incentivized, for lack of a better
18 word, to provide different types of arrangements or
19 advice.
20 SECRETARY CAMPBELL: I guess where I'm
21 confused, though, is if that's true for your concern
22 about the class exemption, wouldn't that also be true
23 for the statutory provision which is already in effect?
24 MS. WAGNER: Potentially. But I'm here only
25 to discuss, you know, this class exemption. I think

1 this class exemption goes beyond the statute.
2 MR. DOYLE: Well, setting that aside, you're
3 suggesting that the protections that Congress deemed
4 adequate under the statutory exemption are really not
5 adequate?
6 MS. WAGNER: I think that the conditions that
7 the Department has set forth are good. There's nothing
8 wrong with level fee. I am merely saying that there
9 needs to be another condition to buttress this to be
10 truly protective of plan participants and
11 beneficiaries. So I'm not saying that level fee is
12 bad. I don't know why or how, frankly, you got that
13 from my testimony. What I am saying is that there has
14 to be a little bit more to be truly protective. That's
15 what I'm saying. I'm not undercutting the concept by
16 any stretch.
17 SECRETARY CAMPBELL: I think I'm struggling
18 with the same thing Bob is here, which is if the
19 statutory provision for fee leveling doesn't include
20 this additional protection you'd like to see in the
21 class exemption, even if we were to adopt it in the
22 class exemption and fix it, from your view, from that
23 perspective you would still have the underlying
24 problem, in your view, with the statute.
25 MS. WAGNER: But your job is to take a statute

1 and say, okay, in the real world, what type of
2 regulations can comply with the spirit and the intent
3 of the statute? If the spirit and intent of the
4 statute is to be protective, then I am merely stating
5 that --
6 SECRETARY CAMPBELL: So what you want is not
7 just the class exemption to be altered, but also the --
8 MS. WAGNER: I'm not --
9 SECRETARY CAMPBELL: An NPRM building on the
10 statute itself.
11 MS. WAGNER: I'm not sure that there needs to
12 be an amendment to the statute. I'm not saying that.
13 You have the ability to interpret how the statute
14 should be effectuated.
15 SECRETARY CAMPBELL: Right. So what I'm
16 saying is, you would like -- separate from whatever
17 occurs with the class exemption, you would also prefer
18 that the Department, via regulation, address the
19 underlying statutory provision to provide an additional
20 protection.
21 MS. WAGNER: That may be reasonable.
22 SECRETARY CAMPBELL: Okay.
23 My other question is, do you have any
24 estimate, or do you currently think there is a cost to
25 workers who just simply don't have access to investment

1 advice?

2 MS. WAGNER: No, I don't. You're asking me,

3 do I have an idea as to how subpar the rates of return

4 are for participants and beneficiaries who don't have

5 access to investment advice? Is that what you're

6 asking me?

7 SECRETARY CAMPBELL: Potentially. I'm not

8 sure I'd call it subpar. There are probably a number

9 of different types of common mistakes that may well

10 have impact. Maybe it's in terms of subpar returns.

11 Maybe that's one way to look at it.

12 MS. WAGNER: Well, I'm sure that you can read

13 the *New York Times*, the *Wall Street Journal*, and

14 *Newsweek* as well as I do and you can hear the stories

15 about people when they shouldn't sell and not being --

16 et cetera, but I don't have any proprietary or

17 informational studies in that regard.

18 SECRETARY CAMPBELL: Okay. I was just

19 thinking, in listening to what you're talking about --

20 and I'm not familiar with the studies you were citing

21 on 86 -- I'm forgetting our own PT exemption. Excuse

22 me. On that particular class exemption, you seemed to

23 be suggesting that the concern was the outcome of this

24 group of the beneficiaries of that class exemption with

25 a group that wouldn't have had that, what you called

1 conflicted advice. But it seems like that doesn't
2 factor in the fact that there's a group that has no
3 advice whatsoever and there's a cost associated with
4 that as well, and I'm wondering, how would you rank
5 those?
6 MS. WAGNER: You know, you're absolutely
7 right. That's why you guys are here, to create
8 regulations from diverse perspectives. You're
9 absolutely right. But I think there was a gentleman
10 before me that said that the choice between no advice
11 and bad advice is not a real choice. But, no, you're
12 absolutely right, Mr. Campbell. You have to take all
13 of this into consideration. That's why you guys are
14 sitting there and I'm not.
15 SECRETARY CAMPBELL: I'm not trying to play
16 got-you, I'm just trying to understand your testimony,
17 because you seem to say there were studies that you
18 were citing to on the one hand. I'm just curious if
19 you had an estimate of the cost of no advice that we
20 might use in making that weighing judgment.
21 MS. WAGNER: I understand. In direct answer
22 to your direct question, am I aware of any studies
23 about how participants without investment advice or
24 sufficient investment education do, no, I'm not. But
25 I'm sure they're out there. I'm also sure the wire

1 houses would be happy to provide them to the
2 Department.
3 SECRETARY CAMPBELL: Okay. Thank you.
4 MS. WAGNER: Sure thing.
5 DEPUTY ASSISTANT SECRETARY LEBOWITZ: In your
6 practice, do your clients tend to be large businesses,
7 small businesses?
8 MS. WAGNER: That's really a good question,
9 because I clearly will shade whatever testimony anyone
10 would give. My practice has, thank God, evolved over
11 time. I used to do micro plan sponsors and now I do
12 macro plan sponsors and micro. My client base is
13 primarily plan sponsor based, but I also do have wire
14 house clients, do have mutual fund clients.
15 But it's primarily -- and I do have the
16 different intermediary distributors, RIAs, IARs,
17 brokers, dealers, broker-dealers, duly registered, et
18 cetera. But the way that I came up in the world is by
19 representing the plan sponsor, so that shades my view
20 of things, especially what you guys do.
21 DEPUTY ASSISTANT SECRETARY LEBOWITZ: In your
22 sense among your plan sponsor clients, do you sense
23 that there's a high level of interest in providing
24 investment advice to their clients?
25 MS. WAGNER: Absolutely. There's great

1 interest in this. The plan sponsor community, frankly,
2 is grateful that you guys are tackling this. There's
3 great concern, however, in the community, from what I
4 can tell, about the provision of conflicted advice and
5 how that might affect plan participants, beneficiaries,
6 and alternate payees, and never mind the fiduciary
7 exposure of the plan sponsor, but really how will the
8 net effect be on the plan participants. There is just
9 concern and confusion.
10 DEPUTY ASSISTANT SECRETARY LEBOWITZ: So are
11 you suggesting then that, as proposed, plan sponsors
12 may not provide --
13 MS. WAGNER: I think right now people are
14 sitting on the fence trying to figure this all out. I
15 haven't seen much movement utilized in this particular
16 statutory exemption. I do believe that maybe over time
17 there will be much more, and greater, movement into
18 managed accounts, into the provision of investment
19 advice, et cetera. I think that is definitely a wave
20 of the future.
21 I'm merely here to respectfully state that
22 maybe another condition to obviate any potential
23 negativity of even disclosed self-dealing might be
24 something that you could appropriately consider. But,
25 no. There's great interest, Mr. Lebowitz, with respect

1 to managed accounts, investment advice, going beyond
2 your Interpretive Bulletin 96-1. There's great
3 interest and great satisfaction that you guys are
4 moving that way.
5 MR. TAYLOR: How would this benchmarking
6 condition that you've suggested work? At what point in
7 time would you decide that a particular advice had not
8 met the benchmark? I'm having trouble sort of grasping
9 how we --
10 MS. WAGNER: Do you know what I was thinking
11 about at 3:00 in the morning last night? I was
12 thinking--this is sad, but true--that someone was going
13 to ask me that question, and it had to be you. Again,
14 I think it's going to be like to like, apples to
15 apples. I didn't have an answer at 3:00 in the
16 morning, and I don't have an answer at 12:00 noon. But
17 it's going to be over a reasonable period of time, it's
18 going to be reasonably similar. Again, that's what you
19 guys are here for.
20 Maybe you should go out and ask for comment
21 from the wire house community or from the duly
22 registered community and say what would be reasonable.
23 But I would think, after a three- or five-year period
24 of time, almost like a look-back to see if there's like
25 a 100 basis point discrepancy on the subpar range for

1 IRAs, for example, that could indicate a problem.
2 Maybe there should be a payback or a suspension of the
3 exemptive relief. But there's got to be a little
4 thinking outside of the box here.
5 MR. DOYLE: Do you not think that as a
6 practical matter that would have a rather chilling
7 effect on an advisor giving advice if they knew at some
8 point, no matter how well-based or well-founded the
9 recommendation is, that in six months or a year they
10 could be determined to have engaged in a prohibited
11 transaction?
12 MS. WAGNER: There are ways of ameliorating
13 that which you, the government, I'm sure can think of.
14 But there's got to be a way to look back and see the
15 effect, if you're going to do this, of this exemptive
16 relief and to see if, in fact, people are being harmed
17 by it, and if so, figure out how to proceed either
18 retroactively or prospectively.
19 MR. DOYLE: You have more confidence in our
20 abilities, perhaps, than I do.
21 MS. WAGNER: Oh, Bob, I've watched you for 22
22 years. You have a lot of abilities.
23 MR. DOYLE: It's a very hard test to develop.
24 Thank you.
25 MS. WAGNER: But this is a multi-trillion

1 dollar industry and this is what your job is to do.
2 The fact that things are difficult, all of this is
3 difficult. This has taken forever to get you guys
4 moving this far. All I'm saying is that there's got to
5 be some type of objectivity to look back and determine
6 whether it's protective. You should look at the
7 results of 86-128 and figure out what lessons can be
8 learned. That's all I'm saying.
9 MR. DOYLE: Well, I mean, typically we look at
10 the circumstances under which the decision or
11 recommendation is being made at the time. I don't know
12 that we've applied a look-back test, per se.
13 MS. WAGNER: But that's the only way you know
14 if this -- for example, and I'm not saying there is, if
15 there's a churning effect, if there's a skewing effect,
16 there's no way of knowing that without analyzing it and
17 that is just guesswork.
18 MR. PIACENTINI: I have three questions and
19 they're each a follow-up on one of the questions that's
20 already been asked, I guess.
21 The first one circles back to the conversation
22 you were having at the beginning of the questioning
23 about fee leveling and whether it's enforceable. I
24 think most of the conversation had to do with whether
25 it's enforceable at the level of the individual giving

1 the advice, and you were saying that all these
2 different kinds of ways somebody could be incentivized,
3 to use your term. Then Brad was engaging you in a
4 conversation about the statutory exemption where the
5 fee leveling rises up higher to the entity level.
6 So I guess my question is, do you have the
7 same concern or not about whether you can monitor fee
8 leveling at the entity level, that you do about whether
9 -- you believe you can't monitor it so well at the
10 individual level. Can it be monitored at the entity
11 level?
12 MS. WAGNER: You had three questions?
13 MR. PIACENTINI: I'm going to do them one at a
14 time, if that's okay. That's the first one.
15 MS. WAGNER: I think there's probably more of
16 an issue at the individual level, but that's not to say
17 there isn't an issue at the institutional level. I'm
18 saying there's probably more of an issue at the
19 individual level.
20 MR. PIACENTINI: Okay. Okay.
21 The second follow-up question has to do with
22 the 86-128 exemption. You've talked about how you
23 believe there have been problems there. Then in
24 response to some questions, you said that there wasn't
25 a specific study. I guess I want to zero in, because

1 in your written comment there was a statistic offered
2 with respect to an unnamed particular institution, I
3 guess, that IRAs had underperformed by a certain
4 amount. I think it was 30 basis points. Thirty
5 percent worse. I'm sorry, not 30 basis points, 30
6 percent worse, and that you attribute that to churning.
7 I wondered, is there some corroborating data or
8 something that --
9 MS. WAGNER: I think the best thing that you,
10 the Department, can do is seek out the -- I would ask,
11 perhaps, the five top broker-dealers that have utilized
12 this to assist you in determining the results of 86-
13 128. There's nothing publicly available, but I'm sure
14 you have your ways and your contacts of procuring
15 information.
16 MR. PIACENTINI: But you're not in a position
17 now to provide something underlying that statistic?
18 MS. WAGNER: I'm not. My good faith.
19 MR. PIACENTINI: Okay.
20 MS. WAGNER: My honor as a gentleman, lady,
21 whatever.
22 MR. PIACENTINI: Okay.
23 Then my third question then is to follow up on
24 the question about benchmarking and how that would
25 work, or whether it can work. I guess my question

1 there is, I have a couple of immediate things that come
2 to mind. One, is that returns are noisy so sometimes
3 the differences, even over a fairly extended period
4 between one thing and another can just be the random
5 component, if you will, as opposed to some systematic
6 component.
7 But then the other thing that comes to mind is
8 that there is self-selection going on. I'm the
9 economist on the panel, so excuse me for using some of
10 these terms. But --
11 MS. WAGNER: I was once an economist. Not to
12 worry.
13 MR. PIACENTINI: Okay.
14 MS. WAGNER: I wasn't any good, though.
15 MR. PIACENTINI: The people who choose to use
16 advice might be somehow different from the people who
17 don't choose to use advice, and so to me, if I want to
18 say, well, if I see a performance difference, or a
19 churning difference, or any kind of difference in the
20 behavior of the two groups, I'd want to know, well, is
21 that caused because of the advice or because of
22 something else that distinguishes the people? So you'd
23 almost have to --
24 So I guess my question is, are you proposing
25 that you would just have an on-its-face comparison of

1 two numbers or would you propose that we'd actually
2 have to untangle the different possible explanations
3 for the difference between the two numbers?
4 MS. WAGNER: I think that would be impossible.
5 The latter would be impossible. In other words, to
6 try to select or try to back out the self-selection, I
7 think would be difficult. But you're looking at such
8 large numbers -- I'll just use Morgan Stanley, who was
9 here a little while ago. They must have a million
10 IRAs, you know?
11 MR. PIACENTINI: Yes.
12 MS. WAGNER: You're looking at such large
13 numbers --
14 MR. RYAN: 1.5.
15 (Laughter)
16 MS. WAGNER: That was a really good guess on
17 my part. I had no idea. You know, you're looking at
18 such large numbers, that even if there is some kind of
19 self selection in the margins, it's not going to affect
20 1.5 million versus -- so I'm not saying that isn't a
21 good point about self-selection. What I'm saying is,
22 when the numbers get so big, that that -- can die a
23 little bit. But you do apples to apples as best you
24 can.
25 MR. PIACENTINI: Right. Now, when I made my

1 first point, though, when I said some of the difference
2 in returns is just noise, you were kind of shaking your
3 head at me. So what's your reaction?
4 MS. WAGNER: Another thing on the noise is,
5 yes, you're right, over 6-, 8-, 9-, 10-, even a 12-
6 month period. But if you look at a longer period, that
7 shakes up.
8 MR. PIACENTINI: How long?
9 MS. WAGNER: I knew you -- I'm an ERISA
10 lawyer. But at the end of the day, reasonable people
11 would know this. So there's got to be studies on this
12 for 2 years, 36 months --
13 MR. PIACENTINI: And it might be different for
14 different kinds of instruments.
15 MS. WAGNER: It might be different for
16 different investments. But IRAs are, in general, long-
17 term investments so that noise of the first six or nine
18 months is not as relevant to people that are going to
19 hold an IRA for 30 years.
20 MR. PIACENTINI: Thank you.
21 MS. WAGNER: Sure. That was three. Good.
22 SECRETARY CAMPBELL: One other question on the
23 benchmarking. Does it present a problem, given that
24 the advice is going to the options available under a
25 plan, so if the plan has selected an investment option

1 which, in the long term, turns out to under perform
2 relative to its peers and the advisor says, well,
3 that's the only large cap fund, for example, available
4 to you, pick that one, is that going to make the
5 advisor liable for the fact that the only option of the
6 plan to fill that asset class is one that turned out to
7 be a mutual fund, say, that didn't perform relative to
8 its peers?
9 MS. WAGNER: That's a great question, but I
10 don't think anything in this exemption obviates the
11 issues of 404(a), which is that if there's an option on
12 your investment platform that would not comport with
13 404(a) requirements, that it would have to eventually
14 be removed.
15 SECRETARY CAMPBELL: Well, I certainly agree
16 with that. I'm just saying that it seems there is a
17 constraint here, which is that when the advisor is
18 providing advice about the options of the plan the
19 advisor didn't select those options, so in a sense the
20 advisor is having to buy a pig in a poke.
21 MS. WAGNER: No, I understand what you're
22 saying, Mr. Campbell. However, many advisors,
23 especially the RIAs, are very involved in creating fund
24 selection. Extremely involved. In fact, they
25 essentially do it, from what I've seen.

1 SECRETARY CAMPBELL: Okay.
2 DEPUTY ASSISTANT SECRETARY LEBOWITZ: Thank
3 you.
4 MS. WAGNER: Thank you. Thank you so much for
5 having me.
6 DEPUTY ASSISTANT SECRETARY LEBOWITZ: The
7 final scheduled witness is Claiborne B. Morton.
8
9
10 **NATIONAL RETIREMENT PARTNERS**
11 **By Claiborne B. "Chip" Morton, III, AIF, PRP**
12 MR. MORTON: Just call me Chip.
13 I'm just an average guy. I'm really not. I'm
14 probably the best retirement planning consultant in the
15 country and I really wanted to come up here, but I'm
16 not a lawyer. I'm not representing industry, I'm not
17 representing my firm, but I'll tell you how it's
18 working on the street. I mean, PPA is great.
19 I listen and I hear a lot of things and I want
20 to make comments because I can offer what happens
21 practically versus a lot of the testimony and whatnot
22 that has been given kind of in the hypothetical: for
23 example, the issue on benchmarking. If you're a
24 fiduciary, frankly, my answer to that would be, you
25 follow a prudent process. If that process was followed

1 through -- you don't hold a surgeon accountable if the
2 patient died and he gets sued and he followed the
3 prudent process.
4 Was it a bad operation or did the patient just
5 have an irreparable heart valve? So the benchmarking
6 is kind of difficult. You really have to judge the
7 process, and a very good, well managed model will do
8 not as well as the overall market, but on a risk-
9 adjusted basis it might in a very strong bull market,
10 and then in a down market you're glad you're down 15
11 when everybody else is down 30 percent, which my
12 computer models that I put in place are more along
13 those lines.
14 So my point is, the benchmarking, I think,
15 needs to be addressed from an approach in the
16 beginning, just like the prudent process. I think it's
17 very difficult to go back after the fact and second
18 guess. But anyway, I'm just throwing that in as one of
19 the most recent comments because I've been scratching
20 notes and trying to do this.
21 But what I really want to do for everybody
22 here, both in front and behind me, is to say that
23 somebody needs to represent, and I have a huge passion
24 for my participants. I care about them. So when I
25 have the opportunity, when Phil said -- I said, hey,

1 can a guy like me come up, he said absolutely. I think
2 it's really important.
3 One of the things that I've realized is that
4 all of this -- I don't even understand this class
5 exemption stuff because that happens up here. I
6 practice down here where it's real. I don't even care
7 about all that because I'd rather say, here's what
8 happens on the street, here's the participant, here's
9 what works, now you guys figure out how to -- and it
10 seems like we've kind of done it backwards here lately.
11 For the last 16 years in this business, I have
12 addressed the issue of not being able to give advice
13 because FINRA says you must know your client, and if
14 you're doing it under a BD versus an RIA, you have to
15 know certain things that you can't possibly know on a
16 group basis because you have 600, 700 people.
17 Just so you know, I don't do any doctors,
18 lawyers, accountants, or engineers because I feel that
19 they are very difficult to deal with. But more
20 importantly, they generally are at a level where they
21 have some form of independent advice for an existing
22 relationship with a brokerage firm or something.
23 So I am the labor guy. I have the coal miners
24 in Kentucky, the guy that makes widgets for the Honda
25 plant in Alabama, that kind of stuff. Those are the

1 people that genuinely need the advice more than anyone
2 else because they don't have the wherewithal with their
3 personal lives to command the attention of a local
4 financial planner because a $40,000 average account
5 balance in this country, for the average worker, is not
6 going to command the presence. So it gets me into the
7 computer modeling.
8 But I want to get into the PPA first, just to
9 simply say: yeah! Finally you've lifted the veil and
10 said you can give advice. You've made some excellent,
11 excellent roads into saying, let the guy that does it
12 better follow these procedures. But I really want to
13 add a caveat here. Any stock broker with a series 7,
14 or an insurance agent can go in and be the plan level
15 consultant because he plays golf with the president of
16 the company. Therein lies a lot of the problems that
17 our industry has, the platform itself.
18 How many times have I just wanted to jump out
19 in the back when you were talking about, what if this
20 fund is bad and you inherit it? Well, I would never be
21 the fiduciary advisor in this newly created role unless
22 I worked with the plan consultant or I was the plan
23 consultant to make sure that I maintained the platform
24 with 404(c). Then somebody else mentioned, well, this
25 fund, what if you have two plans merge and there's 400

1 funds?
2 Well, I will fire a client if they will not
3 let me pick the best in class based on their vendors'
4 choices, irrespective of fees, totally level: bid fee,
5 level fee, finders fees. You should outlaw those, too,
6 while you're at it. That's ridiculous. Therefore,
7 most recordkeepers are all pretty good. We're
8 commoditized now, so there's really not a reason to
9 move a plan from principal to wherever. Work with them
10 there. Most have the same funds and whatnot.
11 I mean, we try to make things so complicated,
12 and it's really not on the street if you have a
13 competent, true retirement plan consultant. The
14 problem is, again, we have these cool things for
15 fiduciary advisors. DALBAR, for example, works with my
16 firm, certifying us. The first thing he did was get a
17 list of every client I have, and without my being able
18 to call them, DALBAR called and had to get a reference
19 on every one of my clients. That's a scary thought.
20 But you know what? Anybody can get money. I
21 think anything that's on a 5500 that's derived in a fee
22 for consulting, there should be a minimum level of
23 competency for the plan level guy, too, because if that
24 happens all this stuff you talk about, about -- then
25 you weed out a lot of the bad guys that you're all

1 protecting. Because I understand your job is worst-
2 case scenario.
3 The guy really gets the 401(k) to sell life
4 insurance and make a couple hundred extra grand, he
5 doesn't care about the 25 basis point trail that he
6 gets off the $6 million in assets. Do you see what I'm
7 saying? So it seems to me that PPA came in, and the
8 offering of advice is fantastic. That's great. We
9 need to do that.
10 Now, it seems a little bit more like it pushes
11 towards the one-on-one. It doesn't work on the street.
12 It really is not practical. It's too expensive and it
13 does forebode the potential for a lot of those abuses.
14 Computer modeling? You guys are dead on. The
15 truth of the matter is, computer modeling is spot on.
16 Modern portfolio theory is what all of us study,
17 whether we have a master's degree in this stuff or
18 whatever. That's what we base the portfolio on, right?
19 If you create the platform -- the 401(k) plan
20 level creates a platform, right? You have best in
21 class in each asset class. You don't want the Japan
22 fund or the tech fund. This is for your core
23 investments. If you're that sophisticated, you should
24 have other money that you do those things with.
25 So you build this wonderful platform, and I've

1 been building that platform for a long time. The
2 problem is, participants generally have two to three
3 funds, right, because they do one of two things. They
4 either don't understand and they go to the guaranteed
5 fund and can't keep up with inflation, or they get
6 their statement, they pick the two or three highest
7 returning funds, and they go there until the next
8 statement.
9 Well, from modern portfolio theory, we know
10 that the truth is, odd-lot investors generally do the
11 opposite. They should actually be taking the worst-
12 performing funds, theoretically, if they're going to
13 play that game and invest in those because of the
14 rotation that occurs. But because you don't know when
15 one rotation is going to occur or another, we invest in
16 a diverse portfolio. The 401(k) is not a place to get
17 sexy with your investments. To me, a computer model
18 captures. You want to talk to Damon from AFL-CIO. I
19 wish he could have stayed. I told him, and this is
20 what he really wanted to get across: the computer model
21 is going to pick up 85 to 90 percent. I mean, I'm an
22 investment guy, guys. I'm not a lawyer. It picks up
23 85, 90 percent of the good.
24 You go to a big brokerage office and you're a
25 million dollar guy, and the corner office guy says,

1 come right this way. He asks a bunch of questions
2 about yourself--right, Fred? You give him all this
3 information and then he turns around to a computer and
4 he puts it in and it spits out his pie, and he sells
5 you pieces of the pie or advises you, for a fee, as to
6 what pieces of the pie you want, and then he supposedly
7 maintains it. Well, the 401(k) provides you, assuming
8 -- you've got to always -- see, I always assume the
9 advisor is like me and it's good, the fund is good.
10 If a fund is bad and our investment due
11 diligence shows that after four quarters it hasn't
12 succumbed from its lack of performance, we'll replace
13 that fund with another one. If my plan sponsors won't
14 heed to that advice then I'll fire them, because I'm a
15 fiduciary and I have to be given the authority to do
16 what I do best. I have to have the confidence, like
17 the guy with the heart surgeon.
18 Again, he has to have the confidence to cut.
19 If the patient dies and he knows he followed a prudent
20 process, so be it. I feel the same way. I think we've
21 made things so complicated in trying to protect from
22 the bad guys, the bad advisor -- and there are a lot of
23 them out there because nobody has ever said, you need
24 at least the PRP designation or the AIF designation
25 that many of us have.

1 So, in other words, I would take it a step
2 further and make some kind of minimum criteria for the
3 plan level guys. I have something that didn't have
4 anything to do with class exemptions, but I think you
5 guys need to hear that because this is my opportunity
6 to give it to you guys straight from the street.
7 So, anyway, the computer model. I have put,
8 in January -- imagine me putting people into a computer
9 model in January. If you take an existing plan and you
10 want to apply, because the first thing I did was get
11 DALBAR certified because I was like a dry sponge. I
12 was like, oh, my God, I can give advice now. Cost
13 effective. My plan is 4,000, 5,000 plans. You're not
14 going to sit on one with 4,000 or 5,000 people. It's
15 ridiculous. So the computer model would get back to
16 them. IBIDSA, MorningStar financial engines, those are
17 great. Small plan guys, some guys want to build their
18 own models.
19 On a big plan, you're going to have the
20 recordkeeping system that's probably got one computer
21 model. Plug that model in at least first as a target
22 date. I'd be happy, I just did a national webinar with
23 Plan Sponsor Institute and I'd like to send you guys
24 each the webcast. It kind of compares to target date
25 and everything, managed accounts programs.

1 But if you would take the good platform, apply
2 the computer model, it reads five things off of most
3 payroll data fees: date of birth, just like a target
4 date fund, but salary, gender, State of residence. All
5 these things have something to do in models with risk
6 tolerance. Deferral rate in salary. So if you have
7 all that stuff, that still give a little bit more
8 accurate tweaking of the portfolio than a target date
9 fund, arguably for maybe account balances or QDI. Good
10 job on QDIA. Awesome. That's well, well needed.
11 But when you get in a $20,000, $25,000,
12 $30,000 balance, you know, you really need to be
13 allocated. Then a managed account, a good program,
14 will go in and allow them to go on the Internet because
15 we know a lot of -- you can assume everybody has a
16 computer. Most of my folks probably don't in Kentucky,
17 right?
18 But you go in, whether on paper, form, an 800
19 number, and it gives you the ability to say, well, by
20 the way, I just inherited a half-million dollar
21 insurance policy and it will tweak the portfolio of
22 IBITSA or whoever is managing the program. So if I'm
23 the plan level guy and I put in the program -- for
24 example, just so you'll know, IBITSA charges, and
25 MorningStar now, right about 50 basis points for the

1 smaller balances, and then after $100,000 it's 40, et
2 cetera.
3 So a $100,000 account. Say it's $500, $125 a
4 quarter. That includes trades. If you go to E-Trade
5 and you have 8, 9, or 10 funds, because in a managed
6 portfolio you're going to have at least 10, 11 funds,
7 and they charge $9 a trade -- what is E-Trade? Does
8 anyone have E-Trade? It's like 9 bucks, they advertise
9 on TV. Well, first you've got to know to do the trade,
10 but 9 times 10 is $90, times four. That's roughly the
11 same, but there's no advice. You had to remember to do
12 it yourself.
13 So, computer modeling is still cheap. People
14 go, well, yeah, but the target date fund, you add
15 expenses to the funds. Well guess what? If you go to
16 -- took a $100,000 account, or another brokerage firm,
17 they're going to want 2 percent to do the one-on-one,
18 so you're getting 8 or 9 percent of the recapture from
19 the investment point of view.
20 So I plug in the computer models. If you take
21 an existing plan, here's the thing that might freak you
22 guys out. But honestly, it needs to be opt-out and it
23 needs to not be in a little spit-out-the-model deal
24 where you all think it's great, oh, here's what you
25 should do, Billy Bob. Oh, okay. Great. Well, I'll go

1 home and do that then. Then he goes home, the dog has
2 pooped on the kitchen floor, or his buddy comes over
3 with a six-pack of beer and the average Joe doesn't get
4 around to it.
5 How do I know? I did enrollment in Kentucky.
6 I use them as an example. Three hundred people. Over
7 the course of time, people would go, hey, man, what
8 should I do? You know what? I'm going to be honest
9 with you. If somebody asked me, even before PPA, and
10 they came up, my educated guess is better than their
11 blind stab in the dark.
12 So did I assume fiduciary -- sure I did. But
13 I'm not afraid to say I'm a fiduciary. Companies,
14 dealers, broker-dealers make such a big deal of
15 avoiding that issue. If you're good and you're
16 confident, hey, okay. So what? But am I better? I
17 could probably give you, Brad, better advice than you
18 could, but you know a whole lot more about this boring
19 stuff than -- we have our different fortes.
20 SECRETARY CAMPBELL: I freely admit I need
21 financial advice.
22 (Laughter)
23 MR. MORTON: So the point being is, we all
24 have our things in life. So for FINRA to go, you don't
25 know them well enough, you know what? I know he's a

1 factory worker, he makes $40,000 a year, and I can tell
2 him, without knowing any more information, to go into
3 the target date fund. Guilty as charged. Okay. But
4 you know what? Now we have the ability to do more and
5 it's bona fide. And -- DALBAR, I think they are right
6 now at the forefront of literally calling on my
7 clients. They embraced PPA like we did. I think
8 there's -- I don't know how many of us have gone
9 through it, but it's a little intimidating knowing that
10 they're watching everything I do. But it's great.
11 Again, I wish they were doing it at the plan
12 level because you've got a lot of plans that are in the
13 hands of, as we call them, blind squirrels in this
14 industry. We surely wish that the industry would go
15 towards saying, if you're getting compensation under
16 the 5500, tell us what you know to earn it. But they
17 don't. Guys are making $50,000 a year on these plans
18 that they were just a sales guy.
19 So, anyway, computer models, it's a great way
20 to go. I don't know about all the ramifications and
21 all the legalese it takes to do it, but on the street
22 it gets embraced. Listen to this: in January, I put
23 $100 million, as an example, at one of my vendors.
24 Great West. It doesn't matter, it could have been Pru,
25 Principal, but that's just the one I'm using as an

1 example. About seven, eight plans, about $100 million,
2 something like that.
3 But before I did it, you have to give them 90-
4 day three strike letters, let the participants know
5 that, by the way, on this date in the future 90 days
6 out, control will be taken and we will be -- because in
7 my opinion, participants never should be giving self-
8 direction. They never should. It's ridiculous. Now
9 the problem is they think it's a freedom, and whoa,
10 you're taking something back. Well, I've got to go in
11 there and tell them, it's a freedom you didn't want,
12 shouldn't have had. Pension plans, corporate America
13 got bailed out having to do pension plans. We created
14 DC plans. Participants didn't like that they were
15 borrowing, so corporate America said, fine. You want
16 it in your own name? Fine. You worry about the
17 investments.
18 All we've got to do is foresee -- we'll make
19 this pretty platform and you pick the funds. Okay,
20 we're done, we're off the hook. Ridiculous, ridiculous,
21 ridiculous. We should have said, okay, we agree,
22 companies sometimes steal from the plans, so therefore
23 we'll put it in your own name. But we're still going
24 to give you professional management. We opened that
25 can of worms, now we've got to take it back.

1 Thank you guys so much for the PPA and all
2 that for allowing us to now give advice. I think in
3 the next three or four years we're going to suffer the
4 consequences possibly to the degree of this whole
5 credit crisis, when people with their $120,000 -- the
6 guy in Kentucky says, man, I've got more money than
7 I've ever seen in my 401(k). I've got $120,000. He
8 doesn't understand that his life expectancy from 65 is
9 now 27.2 years. You know, $120,000 is not a lot of
10 money. You know what I'm saying?
11 But their perception is that it is. When they
12 go to retire they're going to come back and want to sue
13 the employer, and it's just going to be a mess. If we
14 had professional investment advice, even with 87 and
15 probably the recent times, I think that our average
16 account balances would be triple what they are. So
17 better late than never, but I am warning, the tsunami
18 is still ahead. It worries me, particularly in light
19 of the credit crunch that we're in.
20 So you know I like computer models, you know I
21 want to represent that some of us are good guys and
22 that we are totally level -- I stopped taking finders
23 fees. Seven or eight years ago I realized, I don't
24 want an incentive to move from Principal, to Pru, to
25 vendor X, to vendor Y.

1 If I move a plan, there's a genuine reason.
2 When you stop having that incentive, you realize
3 there's not a vendor out there in the top 10 that isn't
4 just as good as another vendor. They all offer the
5 same funds. It's been commoditized.
6 Make it work where it is and the participants
7 don't have the -- but you've got to have an advisor
8 that takes control of the clients. If you're going to
9 be a fiduciary advisor, control the platform. If they
10 won't listen to you, at your fund recommendations, then
11 don't accept the fiduciary liability of that plan and
12 fire them, because you will get in trouble one day for
13 having substandard funds and asset classes.
14 So there's so much I could say, guys. The
15 main thing is, I wanted to introduce myself. I'm not a
16 corporate guy. I am. I love my company, National
17 Retirement Partners. We are a group of guys that --
18 we're the four or five in every major wire house firm
19 that did this right, but weren't allowed to call
20 ourselves fiduciaries. We said, guys, we have to call
21 ourselves fiduciaries because we are: if it walks like
22 a duck, talks like a duck, gives advice like a duck,
23 we're a fiduciary. But broker-dealers were, oh, no,
24 no. So we created our own -- to do that, or RIA.
25 So, anyway, any questions about anything you

1 heard today with a simple, non-legal street answer?

2 SECRETARY CAMPBELL: I don't have any off the

3 top of my head.

4 (Laughter)

5 MR. MORTON: So use me as a resource, though.

6 I have a passion for this business, guys. It's not

7 crack. It's a very -- broken system. It's not the

8 best in the world. It's complete, but it's getting

9 better because of you guys. So, class exemption aside,

10 that's what I really wanted to say and offer myself up,

11 and get everybody awake before they go to lunch. No

12 questions? I'm disappointed.

13 MR. DOYLE: No. But thank you for your

14 passion.

15 MR. MORTON: Thank you.

16 SECRETARY CAMPBELL: Thank you.

17 DEPUTY ASSISTANT SECRETARY LEBOWITZ: That

18 concludes the scheduled witnesses.

19

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21 **REMARKS FROM OTHER INTERESTED PARTIES**

22

23 DEPUTY ASSISTANT SECRETARY LEBOWITZ: If there

24 is anybody else who has anything they'd like to offer

25 to the panel, this is the time to do it.

1
2 (No response)
3
4 DEPUTY ASSISTANT SECRETARY LEBOWITZ: That
5 being the case, seeing nobody expressing any interest,
6 this hearing is adjourned. Thank you very much.
7 Remember that the record will remain open until the
8 28th, I believe. Through next Monday, October 27th.
9 Thank you.
10 (Whereupon, at 12:25 p.m. the hearing was
11 adjourned.)
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2 C E R T I F I C A T E

3 This is to certify that the foregoing

4 proceedings of a hearing before the United States

5 Department of Labor, Employee Benefits Security

6 Administration, in the matter of the Propped Regulation

7 and Class Exemption, Investment Advice - Participants

8 and Beneficiaries, held on Tuesday, October 21, 2008,

9 were transcribed as herein appears, and this is the

10 original transcript thereof.

11

12 ________________________________

13 ERIN DENNIS

14 Court Reporter

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