Statement of the Investment Company Institute

U.S. Senate Committee on Health, Education, Labor and Pensions
Subcommittee on Employment and Workplace Safety Hearing:
"Restricting Advice and Education: DOL's Unworkable Investment Proposal for American Families and Retirees"

July 21, 2015

The Investment Company Institute[1] is pleased to provide this statement regarding the U.S. Department of Labor's fiduciary proposal for the hearing "Restricting Advice and Education: DOL's Unworkable Investment Proposal for American Families and Retirees" in the Subcommittee on Employment and Workplace Safety of the U.S. Senate's Health, Education, Labor and Pensions Committee. We thank Subcommittee Chairman Isakson and Ranking Member Franken for the opportunity to provide this statement, and willingness to examine the impact that the Department's proposal will have on American retirement savers.

The mutual fund industry is especially attuned to the needs of retirement savers because mutual funds hold about half of retirement assets in defined contribution (DC) plans and individual retirement accounts (IRAs).[2] The Department's proposal would drastically impact the ability of those retirement savers to obtain the guidance, products, and services they need to meet their retirement goals.

ICI supports the principle at the heart of the Department's proposal—that financial advisors should act in the best interests of their clients when they offer investment advice. In recent testimony, Secretary Perez asserted that the Department, in its proposals, sought to follow a "principles-based approach [that] obligates the adviser to honor the interests of the plan participant or IRA owner, while

[1] The Investment Company Institute (ICI) is a leading, global association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's U.S. fund members manage total assets of $18.2 trillion and serve more than 90 million U.S. shareholders.

[2] At the end of the first quarter of 2015, U.S. retirement assets totaled $24.9 trillion, DC plan assets were $6.8 trillion, and IRA assets were $7.6 trillion. Investors held $3.6 trillion of IRA assets and $3.8 trillion of DC plan assets in mutual funds. *See* Investment Company Institute, *The U.S. Retirement Market, First Quarter 2015* (June 2015), available at https://www.ici.org/info/ret_15_q1_data.xls.

leaving the adviser and the employing firm with the flexibility and discretion necessary to determine how best to satisfy these basic standards in light of the unique attributes of their business."[3]

Had the Department adhered to a true principles-based approach, the Institute would be most supportive. Regrettably, however, the Department in fact chose a different path—it proposed a set of convoluted, inflexible, and highly prescriptive rules that in no way resembles the principles-based approach described in the Secretary's testimony. The unfortunate result is that, if adopted, the proposed rules will severely and negatively impact retirement savers' access to the guidance, products, and services they need to meet their retirement goals.

Today, in separate letters to the Department, the Institute provided detailed comments on the proposed rule defining the term "fiduciary,"[4] the proposed exemptions in connection with that definition,[5] and the Regulatory Impact Analysis justifying the Department's proposals.[6] A fourth letter highlights the key areas of the rule proposal that we believe make it unworkable and conveys at a high level the changes we urge the Department to make to the proposed rules.[7] The letters, which are attached for your convenience, highlight many serious flaws in the proposed rules that collectively make them simply unworkable. The letters also advance numerous constructive suggestions for improving the rules as proposed. The key flaws and recommended changes identified in our comment letters are as follows:

The Department's overly expansive and ambiguous fiduciary definition will impede commonplace financial interactions. The Department has proposed criteria for triggering fiduciary status that, in many respects, are far too intrusive and highly ambiguous. This is a matter of the deepest concern. Fiduciary status entails one of the highest obligations known to law—and carries with it commensurate liabilities. Rules governing what activities give rise to a fiduciary relationship must provide genuine clarity about who does or does not have that status.[8] These rules must not impede commonplace financial interactions, and they must allow plans and retirement savers to obtain investments that meet their needs and to gather a range of market input on which to base decisions.

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[3] Statement of Thomas E. Perez, Secretary, Department, Before the Health, Employment, Labor and Pensions Subcommittee, Committee on Education and the Workforce, U.S. House of Representatives (June 17, 2015), at p. 4, available at edworkforce.house.gov/uploadedfiles/testimony_perez.pdf.

[4] Letter from David Blass and David Abbey, ICI, regarding the proposed fiduciary rule (July 21, 2015), available at www.ici.org/pdf/15_ici_dol_fiduciary_def_ltr.pdf.

[5] Letter from David Blass and David Abbey, ICI, regarding the proposed best interest contract exemption (July 21, 2015), available at www.ici.org/pdf/15_ici_dol_fiduciary_best_interest_ltr.pdf.

[6] Letter from Brian Reid and David Blass, ICI, regarding the Department's Regulatory Impact Analysis (July 21, 2015), available at www.ici.org/pdf/15_ici_dol_fiduciary_reg_impact_ltr.pdf.

[7] Letter from Paul Schott Stevens, ICI, to Thomas E. Perez, Secretary, U.S. Department of Labor (July 21, 2015) available at www.ici.org/pdf/15_ici_dol_fiduciary_overview_ltr.pdf.

[8] Testimony of Paul Schott Stevens before the Department (March 1, 2011), available at www.ici.org/policy/ici_testimony/11_dol_fiduciary_tmny.

Particularly troubling, the Department's proposal would attach fiduciary status to many common interactions that do not entail a fiduciary relationship, particularly with respect to call center, walk-in center, and website interactions. The practical consequence will be quite damaging for retirement savers, as providers may have no choice but to cease offering such services.

Our comment letter regarding the fiduciary definition provides several reasonable suggestions for avoiding this outcome. Chief among them is for the Department to adopt a definition of investment advice that draws a commonsense line between the provision of fiduciary advice and that of information and education.

The Department treats selling an investment product or service as a fiduciary act. Small employers, as well as retirement savers generally, should have the option to choose among a wide range of investment products and services. Service providers should be able to provide investors with information and data about those options, both during the sales process and on an ongoing basis. As we demonstrate in our letter, there is compelling evidence that Congress did *not* intend for ERISA to disrupt the lawful functioning of the securities markets, to prevent retirement investors from accessing investments, or to turn the "ordinary functions of consultants and advisers" into fiduciary activities. The Department's proposals, at a minimum, should conform to Congress's clear intent in the underlying statute.

The Department's "Best Interest Contract" exemption (BIC Exemption), is wholly inconsistent with the principles-based approach promised by Secretary Perez. The Department suggests that the expansive fiduciary definition it proposes can be narrowed substantially by its newly proposed BIC Exemption. We strongly disagree. That exemption as currently drafted is quite useless because of the multitude of ambiguous and impractical conditions to which it is subject. The very granular representations, warranties, and disclosures proposed by the Department are harmful, and in any case are wholly inconsistent with a principles-based approach.

As explained in detail in our comment letters, if it actually intends the BIC Exemption to have any practical value, the Department should simplify it as follows:

- ***Take a truly principles-based approach.*** The BIC Exemption will work only if the Department strips it of excessive conditions. A starting point would be eliminating the proposed contractual warranties and representations. They are not needed to protect investors and only serve to expose firms to significant new litigation risk.

- ***Streamline the required disclosures.*** The proposed disclosures needed to qualify for the BIC Exemption are redundant, granular, costly, and unreasonable. As proposed, these disclosures would serve only to overwhelm retirement investors, in the unlikely event that investors actually read them. The Department should revise the disclosure conditions to align them with the far more workable precedents the Department has adopted under ERISA sections 408(b)(2) and 404(a).

- ***Expand the scope of coverage of the BIC Exemption.*** The BIC Exemption contains exclusions and limitations that needlessly harm broad classes of retirement plans and savers. The BIC Exemption takes a "legal list" kind of approach—long ago abandoned by mainstream trust law—in proposing a list of certain favored investment choices and eschewing other investment choices not on the list. As a result, the proposed rules would unnecessarily and inappropriately restrict retirement investors' choices. This is, quite simply, an altogether improper role for the Department or any other regulator, and it should have no place in a final rule. In addition, the Department must expand the BIC Exemption to cover advice provided to all small employers. There is absolutely no sound policy justification for refusing sponsors of small plans access to information and advice about the retirement plans they sponsor and administer.

- ***Eliminate compliance traps.*** The proposed written policies and procedures requirement for "material conflicts of interest" pose insuperable compliance hurdles for advice providers. The Department must clarify and simplify these requirements.

- ***Avoid retroactive application of the rules.*** The Department must modify the proposed exemption so that it does not unnecessarily harm investors by prohibiting ongoing advice on assets acquired prior to the rules' implementation dates.

The Department's speculation about a streamlined exemption for "high-quality low-fee" investment options poses numerous conceptual issues that preclude meaningful comment. Through its proposal, the Department solicits comments on a "streamlined" exemption from ERISA's prohibitions for so-called "high-quality low-fee" investment products. Such questions are puzzling. The Department does not actually propose such an exemption; nor does it specify how such an exemption would work or indicate what investments would or would not qualify. We have grave concerns about the feasibility and wisdom of such an exemption, and the Department clearly has not provided sufficient information about this aspect of its proposal to allow the public to comment in any meaningful way.

The Department's Regulatory Impact Analysis does not support its proposal. The Department's Regulatory Impact Analysis is fatally flawed: it simply does not support the Department's assertion that there is a "substantial failure of the market for retirement advice." The Department does not, for example, consider facts that contradict its conclusions. One key example illustrates the point. The Department bases much of its conclusion on the supposition that funds sold through a broker "underperform," possibly due to loads that are taken off the top and/or poor timing of broker sold investments. It contends that such underperformance could cost IRA mutual investors "$430 billion over 10 years and nearly $1 trillion across the next 20 years." Contrary to the Department's claims, however, a review of widely available data shows that investors who own funds that are sold with front-end loads actually have concentrated their assets in funds that outperform—not underperform—their Morningstar category. The Department clearly failed to test its theories against available factual data leaving the Regulatory Impact Analysis without legitimacy.

The Department's Regulatory Impact Analysis also does not properly consider how the proposal could limit retirement savers' access to guidance, products, and services, or how such limits could affect savers—particularly lower- and middle-income savers with smaller account balances. Significantly, if the Department adopts the proposed rules without the changes we recommend in our accompanying comment letters, the Institute estimates that retirement investors' returns could be reduced by $1.1 billion in the first year and by more than $11 billion a year in the tenth year as a result of the additional fees they will pay to fee-based financial advisers on assets that were formerly in front-end load share classes. Factoring in the additional costs of moving some investors with larger balances from broker-sold funds to fee-based accounts, plus the lower performance for investors who would not be eligible for fee-based accounts, it is possible that annual losses to investors could mount to nearly $19 billion a year within ten years.

The Department should be required to revisit the analysis to ensure that the economic justification for the proposed rules meets at least the minimum expected of regulatory agencies, for in its current form it surely does not. We believe that doing so should lead the Department to the conclusion that a different, more targeted, and principles-based approach to fiduciary rulemaking will best serve the interest of retirement savers.

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On behalf of the Institute and all of our members, the Institute thanks this Subcommittee for its efforts in promoting open, ongoing dialogue in connection with the consideration of new expansive rules in this important area. Should you or your staff require any additional information or have questions regarding our comments, please contact David Abbey, Deputy General Counsel–Retirement Policy, at 202-326-5920 or david.abbey@ici.org, or David Blass, ICI General Counsel, at 202-326-5815 or david.blass@ici.org.

Attachments