AMERICANS
FOR FINANCIAL REFORM
ACCOUNTABILITY ★ FAIRNESS ★ SECURITY

Americans for Financial Reform
1629 K St NW, 10th Floor, Washington, DC, 20006
202.466.1885

Statement of Americans for Financial Reform Policy Director Marcus Stanley In Support of the Department of Labor's Conflict of Interest Rule

(Delivered at the Public Hearing August 12, 2015)

As we stated in our comment letter, Americans for Financial Reform supports the Department of Labor's proposed expansion of the coverage of ERISA fiduciary duties. This expansion is long overdue. Over the forty years since the existing DOL rule was written, retirement markets have transformed and workers have become overwhelmingly reliant on self-directed savings. Due to the loopholes in the current rule, brokers providing advice on such self-directed savings can easily evade the fiduciary protections that Congress intended to provide to workers saving for their retirement through employment-based plans.

As extensively documented in the DOL Regulatory Impact Analysis, effective regulation of conflicts of interest in investment advice for retirement savers should save investors tens of billions of dollars annually. There has been a concerted effort by some commenters to discredit this conclusion. However, none of the critiques we have seen has provided a convincing refutation of its fundamental findings. A very wide range of independent studies using different sources and methods – ranging from the analysis of decades of mutual fund returns, to natural experiments creating random variance in investment practices, to 'mystery shopper' audits of brokers giving financial advice -- have consistently found strong empirical evidence that advisor conflicts of interest lead to lower investor returns. Particularly given strong theoretical and experimental evidence that markets for investment products are highly unlikely to be self-correcting based on consumer choice alone, these findings provide powerful support for the common sense conclusion that advisor incentives matter enormously to retirement investors.

Another conclusion one can draw from these findings is that an effective rule will face strong opposition from those in the financial sector who benefit under the current system. Gains to investors who are no longer steered into high-cost products generally represent losses to the seller of the investment product. So the billions of dollars that investors stand to gain from a strong rule are also billions of dollars in reduced profits for Wall Street professionals.

The DOL must not weaken or reverse this rule in the face of criticism from those who profit through conflicted financial advice. If this rule did not impact the profits of some in the financial industry, it could not achieve its goal of benefiting investors. Furthermore, even in this initial proposal the Department has already gone to great lengths to accommodate the concerns of financial professionals operating under potentially conflicted business models. Rather than simply ban payment incentives that could create broker conflicts of interest, the proposed rule permits a range of such payments under the 'Best Interests Contract Exemption', so long as enforceable contractual protections are provided, conflicts are managed through appropriate policies and procedures, and fee disclosures are made. In this respect the proposed rule is far more moderate than current regulatory scheme in the UK, which bans sales commissions altogether. Under PTE 84-24, the proposed rule also continues to permit special exemptions for insurance agents who sell annuity products not defined as securities, despite the fact that many observers have singled out such annuities as having high potential for abuse.

Somewhat ironically in our view, critics of the rule are now saying that these accomodations to industry concerns are 'unworkable' and impractical. Of course, if there are reasonable changes that facilitate the process of signing the best interest contract or communicating disclosures then such changes should be considered. But let's be clear. If a company finds it impossible to sign a legally binding commitment to put client interests first when giving advice, or to change its policies to ensure that advisors do not face incentives that conflict with the best interests of their clients, then it is simply trying to evade a real fiduciary commitment. We are concerned that some in the industry will not be satisfied until all concrete and practical limitations on the conflicts of interest created by incentives to sales personnel are removed. This would reduce the fiduciary duty to a vague and general assurance that advice will be in the best interest of their clients, even as the incentives for front-line personnel were structured to produce the opposite effect. A fiduciary standard will simply not be effective without real, enforceable restrictions on high-powered incentives to act against the client's interests.

Even if not a word in the proposed rule is changed, the Department will still face challenges in ensuring that the Best Interests Contract Exemption does not permit inappropriate conflicts of interest, and that carve-outs provided for educational information and sales transactions are not abused. If the Department also permits the host of additional exemptions, exclusions, and accomodations demanded by industry commenters, these challenges will become insurmountable. We urge the DOL to resist calls to weaken the proposed rule.

The Department should also not be distracted by calls to defer to other regulatory agencies. Through ERISA, Congress has entrusted the Department of Labor with the unique responsibility of safeguarding workers who save through employment-based retirement plans. Unlike the SEC or state insurance regulators, DOL's jurisdiction is not limited to particular types of financial assets, but encompasses all retirement savings that flow through employment-based arrangements. Given the central role of such retirement savings for middle class families and the special tax benefits that accrue to them, it is entirely reasonable that Congress designated these savings for special protections. Only the DOL has the power to create a consistent fiduciary standard that encompasses all employment-based retirement savings. And in practice, other regulators have not stepped forward with actionable proposals to expand fiduciary protections even in the areas that they oversee, despite the clear need for such expansion.

Finally, it should be clear that claims that the proposed rule would cripple access to investment advice for small savers are false. First, it is these savers who can least afford the hidden costs of the current business model. Further, there are numerous providers of fiduciary advice prepared to serve such savers at a reasonable cost. Registered investment advisors already serve some 30 million clients under a fiduciary duty. Organizations such as the Garrett Planning Network and the XY Planning Network provide face-to-face fiduciary investment advice for affordable hourly fees, without any minimum asset requirements. And as discussed in the DOL's regulatory impact analysis, new developments in the provision of automated investment advice are allowing so-called 'robo-advisors' to provide fiduciary advice at lower prices than ever before. Such technology may indeed be the wave of the future in investment advisory services. It is telling that numerous comments in support of the proposed rule come from individuals or organizations that already provide investment advice to low and moderate income clients under a fiduciary standard, as well as organizations that represent such savers.

Thank you for the opportunity to testify before you today. We greatly appreciate the extensive efforts the Department has made to reach out to all those affected by the proposed rule, and look forward to further engagement.