PENSION RIGHTS CENTER
PROTECTING AND PROMOTING RETIREMENT SECURITY
1350 Connecticut Ave., NW, Suite 206 | Washington, DC 20036-1739
P: 202-296-3776 | F: 202-833-2472 | www.pensionrights.org

Statement of Norman Stein on Behalf of the Pension Rights Center
before the Department of Labor
on Proposed Regulations Defining Fiduciary

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Good morning. I am Norman Stein, and I am testifying today on behalf of the Pension Rights Center. The Center is a nonprofit consumer organization that has been working since 1976 to protect and promote the retirement security of American workers and their families.

The Department deserves high praise for these proposed regulations, which would replace current regulations, adopted in 1975, that tightly circumscribe the circumstances under which a person or entity becomes a fiduciary when providing investment advice to a plan for a fee. The original regulations were not compelled by the statute and in our view reflected an improper agency narrowing of both statutory language and Congressional intent. In addition, as the Department suggests in its preamble to the proposed regulations, economic and legal developments in the fields of investments and employee benefit plans have rendered the 1975 regulations anachronistic and, at times, at cross purposes with the statute.

My statement today will cover five points: first, that the current regulations improperly constrict the statutory definition of fiduciary; second, that the current regulations were promulgated in a different economic and legal environment than today and as a result sometimes fail today to shield unsophisticated participants in retirement plans from investment advice tainted by conflicts of interest; third, that the proposed regulations should not condition fiduciary status on whether a person provides "individualized" investment advice; fourth, that the "sales" limitation on the definition of fiduciary status should not apply to advice given to participants; and fifth, that advice about distributions should be considered investment advice.

1. The 1975 Regulations Improperly Narrowed the Meaning of Investment Advice.

ERISA provides straightforwardly that a person is a fiduciary if he "renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so." The 1975 regulations, however, narrowed the scope of this language by limiting fiduciary status to persons rendering investment advice

that is “regular,” rather than one-time or episodic; that is given pursuant to an agreement or understanding that it will be a “primary basis” for investment; and that is “individualized” to the particular needs of the plan.

These limitations are not consistent with the plain meaning of the term “investment advice,” and at least in retrospect can be said to have impeded rather than advanced the Congressional goals of limiting self-dealing and of assuring prudent investment of plan assets. As the Preamble to the Proposed Regulations notes, people providing investment advice not covered by the current regulations have considerable influence on the decisions of plan fiduciaries and participants and yet can have conflicts of interest that result in lower returns and thus less retirement income. The current regulatory definition is also inconsistent with the common judicial observation that Congress generally intended the term fiduciary to be “broadly” construed.

2. Developments in Retirement Plans and Investments Since 1975.

The existing regulations were promulgated in 1975, at the dawn of the ERISA era. Since then, there have been significant changes in the retirement plan and investment landscape that have undermined whatever arguable justification there might have been in 1975 for the regulations’ cramped scope. As the preamble to the proposed regulations notes, there has been a seismic shift in the retirement plan world from defined benefit plans—in which investment advice was generally rendered to sophisticated plan fiduciaries—to self-directed defined contribution plans—in which investment advice is issued to individual participants, many of whom have only rudimentary financial literacy. Mutual funds, and sellers and brokers for mutual funds, who played a relatively small role in retirement plans at the time ERISA was enacted, have become dominant players in the new economic order. The variety and complexity of investment products has also increased markedly over the last three decades.

There have also been significant and unanticipated legal developments since the time the 1975 regulations were promulgated. The Supreme Court in 1993 ruled that a participant generally is entitled to legal relief under ERISA only against a defendant who is a fiduciary whose breach of duty caused monetary loss to a plan. Legal relief is not available against a non-fiduciary even when a non-fiduciary knowingly and for personal profit assisted a fiduciary in the commission of such a breach. A participant can sue a person other than a fiduciary only for equitable relief and the Supreme Court has narrowly circumscribed the extent to which such equitable relief is available. The DOL, which filed amicus curiae briefs arguing against these positions, could not have known in 1975 that the combination of its narrowly drawn regulation and ERISA preemption would effectively create a largely unregulated playing field for so many actors who have a direct and substantial impact on plan investment performance.

Another important change is simply the growth of assets held by qualified retirement plans. In 1975, defined benefit plans and defined contribution plans held $300 billion in assets. In 2007, the year before the financial crisis, qualified plans held over $6 trillion dollars of assets and this figure does not include individual retirement accounts. Retirement plans are thus today a critical market for virtually all serious capital market participants. It is, simply, where the money is. Notwithstanding a somewhat broader definition of the term fiduciary, vendors of investment products and financial advisers will continue to serve the retirement-plan market even if they will now be required to provide prudent and impartial investment advice. Those who are unwilling to meet such a standard, in our view, have no business advising retirement-plan participants on how to prepare financially for retirement.

3. Specific, even if non-individualized advice to participants should be considered investment advice.

The proposed regulations make a person who issues investment advice a fiduciary only if the advice is "individualized to the needs of the plan, a plan fiduciary, or a participant or beneficiary." We are not certain why a person should be a fiduciary only if his advice to a participant or beneficiary is sufficiently individualized (and the proposed regulations do not discuss when advice is sufficiently individualized to meet this requirement). Many plan participants and beneficiaries will be unable to discern a difference between individualized and non-individualized advice. Moreover, this aspect of the regulation may provide perverse incentives to some providers of investment advice to avoid tailoring their advice to the particular needs of the individual, for the purpose of avoiding fiduciary status.

At least with respect to participants, we would prefer that the regulations provide that advice that is directed to a particular participant to purchase or sell a security is investment advice even though not necessarily individualized to the particular needs of the participant. If the final regulations take this position, the Department can clarify in the Preamble to those regulations that this will not prevent the furnishing of non-fiduciary investment education, so long as the participant is not given specific investment recommendations.

4. The Seller Limitation on Fiduciary Status Should Apply Only to Fiduciaries.

The proposed regulations also provide that a person shall not be considered to be a fiduciary investment adviser if such person can demonstrate "that the recipient of the advice knows or, under the circumstances, should have known, that the person is providing the advice or making the recommendations in its capacity as a purchaser or seller of a security or other property, . . . whose interests are adverse to the interests of the plan or its participants or

beneficiaries, and that the person is not undertaking to provide impartial investment advice."

While we believe that this limitation may be appropriate when such advice is provided to a sophisticated plan fiduciary, it is not appropriate when the advice is given to individual participants or their beneficiaries. The Center has worked with participants for 35 year, and based on our experience it is our view that many plan participants will not be able to discern when advice is impartial or conflicted. In addition, even if there is express disclosure of a fiduciary's conflicts, in a one-to-one meeting, whether in person or by phone, an unsophisticated investor will often regard the adviser as acting in his interest notwithstanding the disclosure. Indeed, an adviser/salesperson's success may depend on whether he can create in a customer the belief that the adviser is interested primarily in the customer's welfare, despite a declaration by the adviser of self-interest.

There is the further fact that most participants will not be knowledgeable about the types of fees and benefits that can accrue to the purchaser or seller of securities, and thus may not be able to evaluate the extent of the adviser's conflicts. Thus, we strongly urge the Department to revise this limitation so that it only applies to advice and recommendations given to sophisticated plan fiduciaries.

5. Advice on Plan Distributions is Investment Advice.

The Department asked for comment on whether and to what extent the final regulation should define the provision of investment advice to encompass recommendations related to taking a plan distribution.

A recommendation to remove assets from the plan and invest them elsewhere is, in effect, a judgment about the relative merits of the plan options and the other investment(s). The person making the recommendation can have interests adverse to the plan participant and the recommendation can have a substantial effect on a participant's retirement security, not only because of future investment performance, but also because of the loss of an economically efficient means of taking retirement income in annuity form, and tax considerations. Moreover, under the current interpretation of the Department, the person giving advice in these circumstances has no obligation under ERISA to reveal conflicts of interest. We thus believe it essential that the regulations treat advice on plan distributions for what it is, a specific type of investment advice.

Conclusion

In sum, this is a much needed regulatory change that will better protect plans and participants and facilitate more effective enforcement when misconduct is uncovered. The Pension Rights Center applauds the Department for pursuing this initiative that will benefit both retirement plans and their participants and beneficiaries. Thank you for the opportunity to be here this morning.