Testimony of Peter Schneider

Before the Senate Subcommittee on Employment and Workplace Safety

Of the Senate Committee on Health, Education, Labor and Pensions

Mr. Chairman, Ranking Member Franken and Members of the Subcommittee, my name is Peter Schneider and I am President of Primerica, Inc., headquartered in Duluth, Georgia. Thank you for inviting me to testify today about the U.S. Department of Labor's (Department) proposed new rules governing retirement savings investment advice (Proposed Rule). This is an issue of enormous consequence to our representatives and clients. Having access to quality help in managing household finances is critical in the middle income communities we serve.

Primerica is a leading distributor of basic savings and investment products to middle-income households throughout the United States. Our representatives educate their Main Street clients about how to better prepare for a more secure financial future. We address clients' needs through term life insurance, which we underwrite, and mutual funds, annuities and other financial products, which we distribute. We conduct our securities business through PFS Investments Inc. ("PFSI"), a registered broker-dealer and an indirect wholly-owned subsidiary of Primerica, Inc. As of December 31, 2014, Primerica insured more than 4 million lives and had over 2 million client investment accounts. This year we will pay approximately $1.2 billion in death claims to the beneficiaries of our policies and over time have assisted our clients to save about $50 billion in their accounts. Though most of these accounts are relatively small by industry standards, they are hugely important to the families who have opened them.

Primerica's typical clients are squarely situated in this country's middle class, defined by us as households with an annual income of $30,000 to $100,000, a category that represents approximately 50% of all U.S. households. Our business model is designed to allow us to provide exceptional client service to the middle-income families, and to do so in a sustainable manner. Our representatives are able to concentrate on the smaller-sized transactions typical of middle-income consumers. We will gladly open an Individual Retirement Account (IRA) account for an individual with as little as $250 to invest or $50 per month. We maintain over 1.2 million IRAs.

We offer investment products that are most appropriate for our middle-income clients. We offer open-end mutual funds and variable and fixed annuities, all from well-known and respected companies, as well as different savings vehicles, including non-qualified accounts, IRAs, and college savings plans. Our platform includes off-the-shelf products with commissions on par with commissions paid to other product distributors.

We are believers in educating the households we serve about fundamental financial concepts. Our investment education and philosophy is geared toward the needs of middle-income households, who often are new or less experienced investors. In that regard, we produce easy to understand educational pieces teaching fundamental investing concepts including the critical importance of taking the steps needed to start along the path of financial security. Our primary investing principle is the long-term benefit of dollar cost averaging through systematic investing into a diversified investment portfolio. We

also teach the importance of starting an investment plan early and sticking to it. The issue for our clients is time in the market, not timing the market.

At Primerica, our representatives reflect and serve the communities in which they live. Accordingly, they are well acquainted with the financial challenges facing the middle-income households. The diversity of our sales force, which mirrors the demographics of the middle class, continues to be a primary strength of our company.[1]

This afternoon, PFSI will be filing comments in connection with the Proposed Rule. Our comments make clear that we agree that financial service firms and their representatives should act in each client's best interest and frankly that is why we believe the rules needs to be withdrawn. We respectfully submit that the Proposed Rule would cause significant harm to middle-income individuals and families by restricting their ability to save for retirement through IRAs.

We draw this conclusion first and foremost because the Department's expanded definition of fiduciary turns into a fiduciary act almost every conversation about an IRA that a financial professional might have. ERISA and the Internal Revenue Code prohibit fiduciaries from receiving commissions and other traditional forms of variable compensation in connection with a covered benefit plan such as an IRA unless what is known as a "prohibited transaction exemption" applies and provides relief. Effectively, the DOL's expanded definition of fiduciary makes an exemption from the prohibited transactions rules necessary to continue to effectively serve individuals investing in IRAs. Unfortunately, the exemption the Department has proposed to preserve the commission-based services for IRAs – the Best Interest Contract Exemption (BIC) – is not operational.

Our concern is not the imposition of a "best interest standard." We agree that firms and their representatives should always act in their clients' best interests. In fact, we believe that acting in clients' best interests is critical to our business's long-term success. When our clients can see that they are on the path towards achieving their retirement and other goals, they are more likely to return to us and our representatives, and are more likely to refer their friends and family members to us.

Instead, our primary concern is that the requirements and uncertainties of the BIC exemption are so complex and burdensome that the exemption is neither administratively nor operationally feasible. The trouble is that, from start to finish, the BIC exemption fails to offer certainty. In operating our business, "certainty" with respect to regulatory compliance matters is critical because a failure to satisfy the proposed exemption may result in steep prohibited transaction penalties, including the forfeiture of compensation and excise taxes, as well as consumer lawsuits for breaches of contract, and potentially even class action lawsuits. Critically, the technical implementation of the exemption promises to be a substantial burden, and to cause a significant disruption of services to our clients, with no true added

[1] As of January 2013, both our sales force and our customer base are generally more diverse than the U.S. general population. Approximately half of our life insurance customers and a quarter of our securities customers are either African American or Hispanic American. Mirroring the population we serve, a slight majority of our securities customers are female.

benefits in the way of investor protections. As a result, we believe firms will not use it. Instead, they will restructure their businesses because they cannot rely on the BIC exemption.

This restructuring will mean most firms will move their commission based brokerage IRAs to fee based accounts, known as advisory accounts, or sometimes as "wrap accounts" or "managed accounts." Fee based accounts typically have account minimums, usually beginning at $25,000, and the annual fees are costlier for buy and hold investors than fees associated with commission-based accounts. These higher costs for advisory accounts are due to the higher attendant legal liability, more active nature of portfolio management and greater reporting analytics provided to advisory clients. Further, these higher costs will be imposed on clients who have already determined that they neither want nor need fee-based advisory relationships. They have the choice now of one or the other or both. But 88% of all IRA clients, and 98% of the smaller ones, prefer brokerage relationships.[2]

This shift to advisory services is likely to cause millions of small balance IRA owners to lose access to the financial professional of their choice, or any at all. Those with enough investments to meet the account minimums will face higher costs and experience losses in retirement savings. These resulting losses by some estimates could be as high as $68-$80 billion each year.[3]

There is no doubt that the consequence will be negative to Main Street retirement savers, particularly to long-term buy and hold retirement investors and those with smaller accounts.

We note that our securities regulator, the Financial Industry Regulatory Authority (FINRA), recently stated that "many broker-dealers will abandon … small accounts, convert their larger accounts to advisory accounts, and charge them a potentially more lucrative asset-based fee."[4] FINRA's Chairman and CEO, Richard Ketchum also has observed the exemption's conditions that the DOL imposes on commission-based accounts "are very narrow from the standpoint of broker-dealer activity, and don't really describe a broker-dealer model that I'm aware of from the standpoint of safe harbors."[5]

We note that this would not be the first time the DOL has put forth an exemption with conditions so impractical as to be unusable. In 2011, the Department finalized rules for the 408(g) statutory exemption that were intended to provide prohibited transactions relief for the thousands of investment fiduciaries. Though the DOL predicted that "quality, affordable expert investment advice [would] proliferate" as a result of the 408(g) exemption, to our knowledge, firms have not chosen to rely on the rule.

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[2] Oliver Wyman, *Standard of Care Harmonization: Impact Assessment for SEC* (October 2010) (stating 88% of investors choose commission-based services).

[3] Quantria, *Unintended Consequences: Potential of the DOL Regulations to Reduce Financial Advice and Erode Retirement Readiness*, at 29. *See also*, NERA, *Comment on the Department of Labor Proposal and Regulatory Impact Analysi*s, (July 20, 2015) at 17 (finding that, based on a conservative estimate of the minimum balance for advisory accounts being $25,000, the new fiduciary standard would cause a loss of access to professional advice for 40.49% of retirement account holders resulting in an aggregate cost of $46 billion per year.)

[4] FINRA, Comment on Proposed Conflict of Interest Rule and Related Proposals, RIN-1210-AB32 (July 17, 2015).

[5] Waddell, Melanie, *FINRA's Ketchum Criticizes DOL Fiduciary Plan*, Think Advisor (May 1, 2015).

The reality is that Main Street consumers – families saving what they can each month – will lose access to the beneficial commission-based business services for retirement savings accounts that have benefited them so well and to their chosen financial professional. Tax-advantaged IRAs may no longer be readily available for those with less than $25,000 to invest. As the Proposed Rule only applies to qualified accounts, these households are likely to be limited to investing in non-qualified accounts, or be left with no in-person financial professional to encourage them to save at all.

For a Main Street saver, this will not be good news. Non-qualified savings accounts lack the tax advantages of IRAs, though they are preferable to not saving at all. As a result, middle income savers will experience lower retirement savings, all else being equal. In fact, in a comment to the DOL, Compass Lexecon, one of the world's leading economic consulting firms, reports that a median 30 year old investor would experience a 62.6 percent greater effective tax rate relative to a Roth IRA and a 158.0 percent greater rate relative to a traditional IRA if the DOL's Proposed Rule caused him to save for retirement in a taxable savings account. Compass Lexecon provides a rough estimate that across the potentially 7.0 million households that could effectively be cut-off from access to IRAs as a result of the Proposed Rule, the total reduction in retirement savings would be between $147 and $372 billion if they all opened taxable savings accounts. This calculation illustrates that the Proposed Rule may have very substantial costs which the DOL did not consider. Having one standard for individual retirement accounts and a different standard for all other individual investment accounts will create even more confusion and complexity for individuals than already exists.

The irony is that the Department is missing an opportunity to truly help middle income families. Our experience in serving middle-income families has shown us that the issue for them is not one of conflicted advice. Rather, it is that far too many of them simply have failed to take the critical "first steps" necessary to accumulate meaningful retirement savings. The real conflict they face is between spending and saving.

Saving for retirement is for most people a hard choice, especially for people with finite disposable income, where the decision to allocate a portion of limited resources to saving often means passing on some other purchase or activity. Busy workers and families also often lack the time or confidence to navigate their finances. Yet the DOL's Proposed Rule will make it more difficult for our representatives – who are on the frontlines and living in these most affected communities – to continue to effectively educate middle-income families on the benefit of retirement saving and how to take these important steps toward retirement security.

The value that face-to-face financial assistance can bring to a household is substantial. In a recent study, Oliver Wyman[6] found that advised individuals with $100,000 or less in annual income have at least 38% more assets saved than non-advised individuals, and those of retirement age have more than double the assets of the non-advised. These differences translate into significant improvements in retirement living. The same study also reported that advised individuals more often display investing practices

[6] Oliver Wyman, "The role of financial advisors in the US retirement market," July 6, 2015. (p.3).

associated with long term investing success. Again, we believe that the Proposal will harm middle-income savers by unnecessarily disrupting the relationship between the client and her chosen financial professional.

In fact, the Department repeatedly, and again today, has dismissed the Proposed Rule's potential to cut off help for small savers by suggesting that self-help online investment tools – what the Department refers to as "innovation" – are a satisfactory alternative to personal help. We disagree.

Studies consistently confirm that the percent of Americans comfortable obtaining financial products online is quite low, typically below 10 percent.[7] Even younger generations strongly prefer personal interactions when it comes to retirement investing.[8]

Also troubling is that nearly 60 million Americans remain without access to online investment options,[9] and these are predominantly lower-wealth families and minorities, yielding some disturbing differences that should be concerning to policymakers. Internet usage by Hispanic and African American households still lags behind white and Asian households.[10] There is also a notable geographic gap among rural versus urban households.

While we acknowledge that a computer may be immune to human self-interest, we are puzzled why the Department seems to believe that computer-generated recommendations, calculated without knowing the client, are in the client's "best interests" and lack bias. For example, Wealthfront asks investors five questions before its software makes a wrap account recommendation. Absent from these are questions regarding short term liquidity needs, life cycle events, lifetime income options, employment, short and long term goals, need for qualified retirement savings vs. taxable investments, and a host of others personal to each family.

Unfortunately, the Department's cost/benefit analysis of the Proposed Rule failed to take into account the real-world unintended consequences we are discussing here today that can serve to substantially increase costs. Compass Lexecon, in a report it is filing with the Department, found the Department's conclusions as to the costs of the Proposal to be "fatally flawed." [11] It also determined that the Department's economic analysis of the Proposed Rule "grossly overstates the benefits it purports to

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[7] EBRI 2012 Retirement Confidence Survey **–** "… just 10 percent of [workers and retirees] say they are comfortable obtaining advice from financial professionals online." http://www.ebri.org/pdf/surveys/rcs/2012/EBRI_IB_03-2012_No369_RCS.pdf (See last bullet point on page 1).

[8] Matthew Greenwald Survey – "Despite their familiarity with technology, the Generation X and Generation Y populations prefer traditional means when it comes to retirement education." "Younger Workers Want In-person Education." http://www.benefitnews.com/news/retirement/younger-workers-want-in-person-education-2746146-1.html.

[9] "The 60 million Americans who don't use the Internet, in six charts" https://www.washingtonpost.com/blogs/the-switch/wp/2013/08/19/the-60-million-americans-who-dont-use-the-internet-in-six-charts/.

[10] Pew Internet & American Life Project Surveys, March 200-May 2013; Pew 2012 Research Report *"Digital Differences"* **-** 20% of U.S. Adults Do Not Use the Internet… Senior citizens, Spanish-speaking adults, the disabled, the less educated, and lower earners are among the least likely to go online. 40% of Americans do not have broadband access at home. http://www.pewinternet.org/2012/04/13/digital-differences/

[11] Compass Lexecon, *An Evaluation of the Department' Impact Analysis of Proposed Rules Relating to Investment Advisor Fiduciary Status*, (July 20, 2015) at Par 3.

measure."[12] Importantly, the Department also failed to acknowledge that the costs likely will be passed on to investors in the form of higher fees, particularly to IRA investors with account balances under $25,000.

We would like to note that among the unintended consequence could be the elimination of variable annuities as an option for IRAs. The BIC exemption does not provide a practical pathway for firms to offer variable annuities to IRAs if they also offer any other products, such as mutual funds. Variable annuities typically come with both living and enhanced death benefits. These lifetime benefits are often critical to protecting the best interests of retirement investors. During the market upheaval of the recent recession, they saved many of our clients' retirements. We are greatly concerned about the potential elimination of this important investment option for retirement investors.

As we have explained, the high cost of compliance with the Proposed Rule, and the substantial time and resources required to develop and implement the Proposed Rule, will have broad consequences by affecting the decisions firms make in responding to the rule. While we do not have time to discuss those costs in detail, we do not believe that the marginal fixes that the Department now seems open to considering will sufficiently ease those enormous burdens. For example, even if the DOL makes some adjustments to the rule such as changing the timing of when newly-required contracts must be signed, those contracts would have to be prepared for new and existing clients, new systems would have to be developed and integrated (in some cases with third-parties) to create and manage new disclosures, and compliance policies and procedures would need to be updated. At our firm alone, over 80,000 representatives would need to be trained to comply with the rule. Nor would we expect the changes to resolve the numerous ambiguities within the Impartial Conduct Standards that give rise to potential forfeiture of compensation and excise taxes, as well as consumer lawsuits for breaches of contract and class action lawsuits.

In his testimony today, the Secretary drew the analogy of investment professionals to doctors and lawyers. While we agree that many people regard their financial professional highly, we think it is useful to draw the analogy out to fit the circumstances. We question what doctors or lawyers would do if faced with similar regulation. As with the financial industry, we would not expect the objections to be to the standard of care. But would doctors continue to serve patients if they were required to sign a contract guaranteeing fees and projecting results over 1, 5 and 10 years, give warranties on loosely defined standards that could be challenged by trial attorneys in hindsight, and report volumes of personal patient data, as well as their own compensation, so that it is publicly displayed? We think they would not. We also wonder whether the Department would believe that on-line medical services would be a sufficient alternative for those who were cut off from face-to-face interaction as a result of their rule.

As indicated, a possible outcome of the Proposed Rule is that nearly half of middle-income consumers – those with amounts to invest below advisory account minimums -- will be left with no option to save in an IRA.[13] For many families this may result in decisions to spend rather than to save. For those who

[12] *Ibid*, at Par. 33.
[13] NERA, at 28.

choose saving, only a few can be expected to use online investment options. The others may unknowingly forgo the tax benefits available to IRAs and instead invest through non-qualified accounts. Obviously, this would be contrary to Congressional intent of encouraging retirement savings.

Overall, we believe that the Proposed Rule will harm rather than help middle-income retirement investors. The added litigation and penalty risks will drive increased compliance costs and lead financial institutions and representatives to curtail the services they offer to those families with more limited means.

For the record, we favor a single best interst standard for all the types of accounts and clients we serve. The best policy is a best interest standard that respects the different choices broker-dealers and registered investment advisers offer Americans. In short, it is a standard that helps people save rather than one that sets up narrow guardrails in the middle of the road that effectively serve as a retirement roadblock for the middle-class.

We believe the DOL is sincere in trying to help protect investors from conflicts of interest. That is a goal we share. But the DOL lacks the tools to do the job right. The authority it has to define the word "fiduciary" is insufficient to rewrite the rules governing the entire securities industry in this area.

You should know that it will be the clients, not the companies that are hurt most by this rule. Companies are resilient, and many firms will figure out how to go upscale and focus on a new customer base. The clients are the ones who will lose most. The war being waged every day in the homes we serve -- by people not robots -- is where the family can find $100 a month, $50 even, to start saving for college and retirement. The real problem with the Proposed Rule is it makes what is now an extremely difficult task into an impossible one.

On behalf of Primerica's 101,000 representatives and 2,000 employees dedicated to providing a more secure financial future to our clients, I'd like to thank you for letting me share our perspectives on this critically important matter.