STATEMENT OF
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EMPLOYMENT AND WORKPLACE SAFETY SUBCOMMITTEE
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Thank you for the invitation to appear before the Subcommittee to speak about the Department's proposal to protect workers from conflicts of interest in retirement investment advice. As this Subcommittee explores the issues facing America's workers, I'm pleased to have the chance to discuss this rulemaking, and hope that we can continue to engage in a productive dialogue. We believe that we have proposed a reasonable, middle-ground approach that is responsive to our extensive outreach and feedback. It is grounded in a basic principle – that investment advisers should act in their clients' best interest not their own. The proposal's 90 day comment period closes at the end of today, and will be followed by public hearings that begin August 10th. The comment period will reopen on the day of the hearing and remain open until 14 days after the hearing transcript is published – a process that we anticipate will provide an additional 30 to 45 days of public comment. I want to assure all stakeholders, including Congress, that the Department is appreciative of the comments received to date, which have already begun to sharpen our thinking about potential changes so that the proposal accomplishes its goals in the simplest, most practical way for all concerned.

Retirement security is a fundamental pillar of the middle class. We must ensure that Americans who work hard and save responsibly for retirement are getting a fair share of the returns on those savings. This Subcommittee knows too well that there is a retirement crisis in America and that not enough Americans are saving for retirement. I'm deeply concerned that even if you've done the right thing, worked hard, and saved what you could, you could end up in a situation where you do not have what you need for retirement simply because your adviser isn't required to put your interests first. The majority of advisers already does the right thing and serves the interests of clients first, but most Americans do not have room for error and cannot afford to invest in products with unnecessarily high fees or low returns that benefit their advisers but do not meet their own needs.

Throughout my career, I've seen over and over again that making the right financial decisions is critical to a person's life and future, but that far too often, people don't have the information and tools they need to make the best decisions. When I was in state government and at the Justice Department, I saw firsthand how the foreclosure crisis turned the American Dream into a nightmare for millions of families; I saw how it turned thriving communities into decaying neighborhoods.

The crisis was a function of inadequate regulation and irresponsible, sometimes predatory, lending practices. But it was also a stark reminder of how little so many of us understand the biggest financial decisions we make, and how we so often have to rely on what we are told by professionals, and to trust that they're giving us the best information.

The biggest decisions we're faced with fall into one of three categories: medical, legal or financial. Most people know that lawyers and doctors have an obligation to look out for what's best for you. When you go to a doctor, you expect to get advice that's in your best interest. If you have cancer, you don't want your doctor telling you just what's "suitable" for you. You need your doctor to tell you what's *best* for you. When you hire an attorney, that attorney is legally bound to work in your best interest.

And most people assume the same is true for professionals who provide financial advice. You should expect that when you are relying on someone to provide retirement investment advice, they are going to tell you what is best for you, not what earns the most money for them. But in reality, conflicts of interest and hidden fees too often result in bad advice that is not in our best interests.

There are many advisers who work every day to do right by their clients. Some financial advisers commit to serve your best interests. But others operate under no such commitment, and there's nothing stopping them from getting backdoor payments at their client's expense. The corrosive power of fine print and buried fees can eat away like a chronic illness at a person's savings.

An analysis by the Council of Economic Advisers concluded that this kind of conflicted advice leads to losses totaling about $17 billion every year for IRA investors. Losses due to conflicts of interest, on average, reduce returns for affected savers by about 1 percentage point per year. Over 35 years of saving, this could reduce savings by more than a quarter. And in many cases, the affected consumers don't even know it is happening. The lack of rules of the road is confusing, it creates an un-level playing field, and it hurts working people who just want to be able to save enough to retire comfortably.

When I became Labor Secretary two years ago I committed to slowing this rulemaking in order to ensure that we got it right. During that time, my review of the evidence has demonstrated that there is in fact a large problem that needs to be solved. I heard from too many hard working Americans whose golden years became tarnished when the savings they thought would carry them through retirement disappeared into high fees and poor performance. One of the people whose story I learned is named Phil, a retiree from California. In 2002, Phil was offered a buyout from the company where he had worked for 30 years, and he was presented with three choices: he could ignore the offer and keep working; he could take the company's pension and receive a monthly check of $1,500 for life; or he could take a lump sum of $355,000 – money he had earned. After talking it over with his wife, he decided to call a financial adviser whom the company had brought in a few years prior to provide some retirement advice to employees.

That adviser came to Phil's house, and sat with them at their kitchen table. She encouraged Phil and his wife to take the lump sum and let her invest it for them. When Phil came to Washington recently to tell lawmakers his story, he said "*I will admit, being a blue-collar union employee and being watched over, cared for and protected by the company and the union my entire career, I was ignorant when it came to these financial matters I had to deal with, and I needed professional help.*" As so many of us do every day, Phil and his wife trusted the adviser to guide them in the right direction.

But she didn't do what was in their best interest. Instead, she put Phil's money in investments that weren't appropriate for him, and she misled him about how much monthly income he could safely withdraw. Today, Phil and his wife have lost nearly all of their savings. They live on a strict budget and shop at thrift stores. They're at risk of losing the home they've lived in for more than 40 years. They won't have anything to leave for their kids or grandkids.

In addition to stories like this, the Department's own economic analysis conservatively estimates that the proposed regulatory package would save investors more than $40 billion over ten years, even if one focuses on just the one subset of transactions that have been the most studied. The real savings are likely much larger as conflicts and their effects are both pervasive and well hidden.

Even as I became more convinced of the problem, I knew that we had to act carefully to solve it in a way that protected people like Phil, but that avoided unwarranted disruption to the industry. As I assured this Committee when I appeared before you just a couple of months ago, our proposal serves three main principles: (1) it updates our regulation to protect retirement savings in the much-changed retirement landscape; (2) it allows flexibility so the industry can use its knowledge and expertise to find the best way to serve its clients and continue to innovate; and (3) it meaningfully responds to the input we received in the extensive outreach that we have conducted. I would like now to show how I believe our proposed rule honors those three principles.

The existing DOL rule was put in place a generation ago, in 1975, when most of America's workers did not have to worry about making decisions regarding how to invest their retirement savings. But now that the retirement landscape has changed, our rules have to change as well. When the rules were last overhauled almost forty years ago, Individual Retirement Accounts had just been created and employer-based 401(k)s did not even exist. Today, America's workers have more than $7 trillion invested in IRAs and more than $5 trillion in 401(k)-type plans, which, combined, exceed the value of traditional pension benefits. As more baby boomers retire, more and more of them are moving their retirement savings from employer-sponsored plans into

IRAs, making the protection of rollovers and IRAs increasingly important. Congress created and encouraged the growth of this 401(k) and IRA marketplace by giving those savings tax preference – as a result, under ERISA and the tax code, we have an obligation to ensure that those savings are protected.

The proposal will close the loopholes in the 1975 DOL rule that today make it possible for advisers to exclude from protection the kind of advice relationships that are common now for 401(k) and IRA holders. Under the proposal's new definition, a fiduciary is a person providing investment advice for a fee or other compensation with respect to a plan or IRA if either the person doing so acknowledges he or she is acting as a fiduciary within the meaning of ERISA or the Internal Revenue Code OR the advice is provided pursuant to an agreement or understanding, written or verbal, that the advice is individualized to, or specifically directed to, the advice recipient for consideration in making investment or management decisions with respect to investments of plans or IRAs.

To serve our second principle to allow maximum flexibility, the proposal that we published in April does not include detailed rules as to what advisers can and cannot do to serve their clients. Instead, the proposal has one fundamental tenet that should be unassailable -- retirement advisers should put the best interests of their clients above their own financial interests. This proposal is intended to provide guard rails, but not to be a straightjacket, because we know there is not a one-size-fits-all solution to putting clients' interests first.

Our proposal's second principle is best illustrated by the proposal's carve outs and exemptions, which allow for flexibility and workability. The proposed exemptions from ERISA's prohibited transaction rules would broadly permit firms to continue common fee and compensation practices, as long as they are willing to adhere to basic standards aimed at ensuring that their advice is in the best interest of their customers. Rather than create a highly prescriptive set of transaction-specific exemptions, the Department instead is proposing a set of exemptions that accommodate a wide range of current business practices, while minimizing the harmful impact of conflicts of interest on the quality of advice.

At the heart of the proposal is the best interest contract that would govern the advisory relationship if the adviser is receiving conflict of interest fees or other payments. It is an innovative approach designed to respect existing business models while protecting consumers and leveling the playing field for impartial advisers. This principles-based approach obligates the adviser to honor the interests of the plan participant or IRA owner, while leaving the adviser and 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.

The proposal clearly reflects our third principle – a commitment to being responsive to the substantial input we received from a wide range of stakeholders. My staff and I have met with representatives of all of the major financial industry groups, CEOs of big and small firms in the financial services industry, and representatives of employers who offer retirement plans to their workers. I have also met with consumer groups and civil rights groups who are concerned that their members are the ones who can least afford to see their retirement savings dissipated by conflicts of interest among financial advisers they rely on for investment advice. We have also worked extensively with colleagues throughout the government, including and especially the Securities and Exchange Commission.

I am encouraged by the substantial and growing areas of agreement between the Department and the financial services industry. For example, there is an acknowledgment and acceptance among our stakeholders in the financial services sector that there are significant conflict of interest problems in the marketplace serving retirement investors. There is also a broadening consensus around the core elements of a solution, including 1) an enforceable best interest standard, 2) a requirement that firms carefully design structures and procedures to mitigate conflicts, 3) adherence to the existing securities laws, 4) more effective disclosures to investors, and 5) the need for concrete steps to address fees and other revenue incentives that may improperly influence investment recommendations.

We heard from numerous stakeholders, in both the industry and advocacy communities, that a principles-based rule would work best in this rapidly evolving marketplace. We responded with the best interest contract exemption – a completely new approach that directly addresses these suggestions.

You can also see our responsiveness not just in what the rule will do, but also in what the proposal won't do:

- We heard that banning commissions would cause excessive disruption in the industry – therefore, like the prior proposal, the new proposal does not ban commissions or many other common payments for advisers.
- We heard that including appraisals or valuations of stock held by employee stock ownership plans in this rule was too complicated and not a good fit – so the rule does not apply there.
- We heard that large plans with sophisticated fiduciaries making investment decisions need greater flexibility in dealing with advisers so we included a carve-out for them, commonly referred to as the seller's exception.
- We heard that it was important to provide retail customers who want to direct their own transactions with the ability to place orders without unnecessary process, so the rule will not apply to brokers who just take direct orders from customers and do not provide advice.
- Finally, we heard about the important role that the financial services industry plays in providing much needed financial education. Because we value that role, the proposed

rule does not limit access to financial education. In fact, it would expressly allow employers, call center employees, and other financial professionals to continue to provide general investment education without becoming fiduciaries, and extends this express allowance, historically applicable only in the 401(k) market, to distributions, rollovers and IRAs as well.

The proposed rule and its accompanying Regulatory Impact Analysis includes numerous requests for comments on particular issues – more than any other rule that we have published while I have been Secretary. I think of these specific requests as an invitation to a very real conversation that I hope will prove to be a productive one. Our track record gives us credibility when I say that we are open to making real changes in the rule to improve it, and that's why we urge our partners in the industry and advocacy community to engage in a good faith dialogue during the comment process. For example, we included in the rule some illustrative examples of the kinds of practices and procedures that firms could adopt to meet the requirements of the best interest contract exemption. We hope that comments from stakeholders will address whether these are the right examples or whether there are better ones.

Many of you have raised important questions about how this may affect retirement savers with small balances, something we carefully considered while drafting. I simply don't believe the argument that small savers cannot be served by advice that is in their best interest, especially with the advent of new, technology-based and technology-assisted models. We know that advisers can live up to a best interest standard and still make a living because so much of the industry already does just that. Every day, Americans are served by advisers like the certified financial planner with whom my wife and I work, who has embraced the best interest standard. In fact, the rule will help the best advice win out, because those already selling good products or giving good advice stand to benefit in a world where a client's best interest has to be put first. What I've learned through a robust and exhaustive outreach process is that when you put the interests of your customers first, it's good for your customers and it's good for business. Jack Bogle, the founder of Vanguard, made this concept a cornerstone of his business model, and he and other firms large and small have proven that it can be done to great success.

We have put forth a simple proposition – the client's best interest should come first. So far, we have heard from some who want us to go further and ban all conflicts of interest and end commissions, while others have said that we don't need to act at all. Those comments tell me that we have probably found the right middle ground in providing greater consumer protection in a way that respects the important role played by investment advisers in helping the middle class achieve the American dream of a secure retirement. I am most heartened by the comments that offer suggestions on even better ways to achieve that objective. I hope to continue that conversation here with you.

Thank you again for the invitation to testify.