THE BROOKINGS INSTITUTION

HOW SHOULD RETIREMENT INVESTMENT ADVICE BE REGULATED?

FEATURING KEYNOTES REMARKS BY
SECRETARY OF LABOR THOMAS E. PEREZ

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Welcome:

MARTIN NEIL BAILY
Bernard L. Schwartz Chair in Economic Policy Development
Director, Initiative on Business and Public Policy
The Brookings Institution

Keynote Remarks:

THOMAS E. PEREZ
Secretary, U.S. Department of Labor

Panel 1: Examining the Evidence on Conflicts of Interest:

Panelists:

MODERATOR: MARTIN NEIL BAILY
Bernard L. Schwartz Chair in Economic Policy Development
Director, Initiative on Business and Public Policy
The Brookings Institution

SEAN COLLINS
Senior Director, Industry and Financial Analysis, Investment Company Institute

JANE DOKKO
Fellow, Economic Studies, The Brookings Institution

Panel 2: How Should the Rule Be Implemented?:

Moderator:

JOSH GOTBAUM
Guest Scholar, Economic Studies, The Brookings Institution

Panelists:

KENT MASON
Partner, Davis & Harman

BARBARA ROPER
Director of Investor Protection, Consumer Federation of America

JIM SZOSTEK
Vice President, Taxes & Retirement Security, American Council of Life Insurers

MARILYN MOHRMAN-GILLIS
Managing Director, Public Policy & Communications
Certified Financial Planner Board

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P R O C E E D I N G S

MR. BAILY: So, as I may have said a moment ago, I'm Martin Baily. I'm a senior fellow here at Brookings in economic studies, and I want to welcome everybody to our event this afternoon.

In today's economy, most households need to build up their own savings for retirement, because defined benefit plans are disappearing. However, many people lack the expertise to make good retirement saving decisions by themselves. The Department of Labor has argued that there are problems in the investment advice industry, and specifically, that advice may be conflicted. They have proposed rules governing investments tied to saving out earnings.

Some of those in the industry strongly disagree with the assertion that conflicted advice is a problem, and they say that the proposed rules are complex and will end up depriving many families of needed investment help. At Brookings, we pride ourselves in taking on difficult issues and holding frank, but civil discussion, and that's what we're looking for today.

I do want to make two disclosures. First, one of our panelists today is from the Investment Company Institute, and they are a supporter, a funder of the economic studies program. Secondly, as it says on the Brookings web page, I am on the board of the Phoenix Companies that sells insurance and annuities.

First, we are fortunate that Secretary Perez has agreed to open the even with a keynote speech. This will be followed by two panels. The first will be a discussion of whether and to what extent the evidence shows that conflicted advice is a problem, and the second panel will look at the rule of what it's intended to accomplish, whether it's workable, and whether or not it will result in a reduction in the amount of advice available to households.

So, let me now welcome to the podium Secretary Perez. He has been Secretary of Labor since July, 2013. Prior to holding that position, he was the assistant

attorney general for civil rights in the Justice Department, and from 2002 to 2006, he was a member of the Montgomery County Council, where I'm happy to say, I live. Following comments from Secretary Perez, Josh Gotbaum, who is a guest scholar here at Brookings, will ask some questions of the secretary. Thank you. (Applause)

SECRETARY PEREZ: Martin, thank you for that generous introduction, and thank you for your very distinguished career of service to this nation. And thanks for living in Montgomery County (Laughter). I just learned that today.

It's an honor to be here to talk about one of the most important steps that we can take to enhance retirement security for millions. But first, I want to take a step back to provide some context about why the department's rulemaking in this space, in our judgment, is so urgently needed.

As everyone in the room is aware, we're in the middle of a huge shift in the retirement paradigm. Quite simply, this is not your father or mother's retirement. For much of the 20th century, the path for so many Americans was this. After working 30 or 40 years for the same company, around the age of 65, you would retire, and you'd get a party, a commemorative pen and a defined benefit plan.

Because the pension was a defined benefit pension, the only thing at risk of running dry was the ink in the pen. To quote now, as we move forward to today, that learned philosopher, Bob Dylan, the times they are indeed, a changing. That world is gone, and the Ozzie and Harriet world of defined benefit plans has been replaced by the modern family era of IRAs and 401Ks.

If you ask a millennial if she has a defined benefit plan, well, you might as well ask her if she has a typewriter, as well. In 1975, private sector employee participation in defined contribution plans was less than half that of defined benefit plans. By 2013, it was five times more.

With defined contribution plans as the principle retirement savings vehicle, consumers are responsible for managing their own assets and making high stakes decisions that will impact their financial security for the rest of their lives. And to

do so, they have to master a complex and confusing landscape with hundreds of products about which they know very little, if they don't have a finance degree.

What they need is someone who can help them navigate this terrain. They need retirement advice that they can trust. They need to work someone whom they know is acting in their best interest. The challenge is that after ARISSA was passed in 1974, regulations governing retirement advice were written under that old paradigm in 1975, and they haven't been updates since.

In the early '80s, the earliest data we have, the retirement market was about half a trillion dollars, mostly defined -- mostly in DB plans. Today, that market is 17.4 trillion with more than 13 trillion in defined contribution plans and IRAs. But we're operating under anachronistic rules that were written when IRA was your elderly uncle and 401K was a rural highway somewhere in the Midwest.

So, what we are doing in our proposal is to establish a very basic, commonsense principle, which is that if you give financial advice, you have to put your client's best interests first and not your own. If you think about it, this is really no different than the widely accepted standard we apply when it comes to other important life decisions that demand informed and unbiased advice.

I'm a lawyer. I'm the youngest of five, and all of my siblings are doctors. I had to promise them I would never be a plaintiff's personal injury lawyer, but that's a different story for a different Brookings event. And here is how I like to look at it. When you go to the doctor, or when you consult with a lawyer, you know that they are obligated to give you medical treatment and legal advice that's in your best interest. We would expect nothing less, so why shouldn't you expect and why don't you deserve the same from the professional you've hired to help you prepare for retirement.

Many financial advisors are fiduciaries, and do embrace that high standard, but the majority are not fiduciaries, and do not have to follow this high standard, even though I might add in some cases, their marketing materials suggest that they indeed, do.

The highest bar they need to clear under the current rules is a so-called suitability standard. But you wouldn't accept a mere suitability standard from your physician. If you're making a life or death call with yourself or your wife or your spouse or your mother or your father, you wouldn't want them choosing among several suitable options. You'd want them to know what is best for them. You want to know what will save their life. You don't want to simply know what's suitable for them, and that's what we're talking about.

Without a best interest standard, it's too easy for advisors to benefit from indirect payments and hidden fees. It's too easy for working families to be unwittingly victimized by the corrosive power of fine print. I don't want to take too much time today to talk about chapter and verse, because I have given stories in the past. These are real life stories of people that we have met, and they are heartbreaking.

Families that saw their nest egg vanish because they put their faith in an advisor who they thought was looking out for their best interest, and who may have given suitable advice, but that advice sure didn't work for them. And that is a problem.

In all, according to the conservative estimates of the Council of Economic Advisors, based on data on a subset of the overall market, conflicted advice cost IRA investors some $17 billion a year. When you look at all of the peer reviewed empirical academic studies that have been published in this area, they overwhelmingly support our fundamental position, that conflicts of interest are harming American savers to the tune of billions of dollars.

Various studies have found that investors fare worse when advisors are conflicted, and worse, still, when their conflicts are larger. In other words, the more extensive the conflict, the worse it is for the consumer. Advisors often steer investors who start with low cost investments into pricier alternatives that are on average, performing worse.

The stakes get higher each year as hundreds of billions roll out of ARISSA covered plans into potentially more vulnerable IRAs. The evidence is more than

adequate that prompt and decisive action is necessary. By contrast, I would respectfully add that most of the industry commissioned research reaching the opposite conclusion does not meet equally rigorous analytical standards.

So, let me reiterate something that I have said many times as we move forward, because I think it's important as we have this discussion to be very clear about what this is and what this isn't about. I do not believe that financial advisors wake up every morning with malice in their heart. I don't think it's constructive or accurate to frame this issue around white hats and black hats, although to be sure, there are a few rogue actors out there, and they need to be dealt with.

But overall, this isn't about bad people doing bad things. It's about good people operating under a structurally flawed system where the incentives of the advisors are not properly aligned with the best interest of the customer. Bob Seawright of Madison Avenue Securities, I think makes a very important point when he speaks about a confirmation bias than can convince the advisor that the option that's most lucrative for him or her is the one that's right for their client.

The goal of our rulemaking is to realign the interests of the consumer to make sure that they are aligned with the interests of the advisor. Now, when we started doing our outreach in connection with this rule, I must confess that we heard the following feedback with some degree of regularity. Problem? What problem? The status quo, we were told, is working fine.

But as our conversations evolved, and as our rulemaking process evolved, I'm heartened to have observed a gradual but unmistakable recognition that the importance of a best interest standard is undeniable. Some people have said that they support the standard in principle, but that operationally speaking, it will be too difficult to implement. But the fact is that a substantial segment of the market has already found a way to abide by it and do quite well for themselves, as well as do well by their customers.

We've heard and understand these concerns about the logistical challenges during the comment period, and we remain flexible on the question of how

best to make this proposal work. We want to set parameters and not suffocate the industry. The objective here, as I've said a number of times, is to provide guard rails, not a straight jacket. We know there is no one size fits all template here.

We believe there should be flexibility for the industry to discern the best way, given the unique attributes of their business, to implement a best interest standard while staying towards the center of the road, safely between those guard rails. That's why the proposal includes various carve outs and exemptions to give industry that flexibility.

Flexibility is also baked into the cake of the proposed best interest contract exemption which is designed to accommodate existing business models while still protecting consumers. I've been encouraged throughout this process by the support we've received from many in the financial services industry -- the men and women who are providing retirement investment advice and believe that they can do the right thing for their customers while doing the smart thing for their business.

Industry leaders large and small have come forward to say that the best interest standard is both practical and necessary. For instance, Jack Bogle, the founder of Vanguard, has been one of our most outspoken advocates. He's been in this business longer than most of us have been alive. I'll go out on a limb and I'll say longer than all of us have been alive, just as a compliment, perhaps, to one or two of you, like Sam, in the back.

And you know what? He's been in the business 64 years, and he's built an enormously successful business around the client first approach. He has said that when you look at Vanguard's success, and I quote, "It's proof that it's possible to serve clients well, while minimizing conflicts of interest."

At the other side of the scale, we've also heard from a lot of smaller firms that often serve customers with lower net worth and more modest portfolios. They're on board, too, rejecting the argument that our proposal will slam the door on small savers. For one thing, I think it's important to remember on this small saver issue that low and middle income people have very little margin for error. They're less able to absorb

financial loss resulting from hidden fees or lower returns.

Also, their entry point into the IRA market, which is rolling over funds from job-based plans, is particularly vulnerable to conflicts of interest. So, by reducing the impact of conflicted advice, by creating a climate of accountability and trust, our proposal will encourage small savers to consult with financial advisors.

Successful firms like Wealth Front, the Garrett Planning Network, Financial Engines and Personal Capital are there to occupy this important market niche, and others, as well. These firms already do quite profitably, and they do so while embracing and adhering to a fiduciary standard. When I talk to these firms, and I tell them about the argument that we hear, that the proposed rule will make it nearly impossible to serve small savers, what I hear most frequently is the following: Give those small savers my phone number. I can help them grow their assets, and I can help them make a decent living.

I must admit that I had a conversation about this small saver issue with a brother of mine, who is a doctor in rural America. There is an access problem to healthcare in rural America, but no one has suggested that the solution to the access problem in rural America is to allow my brother to have a lower standard of care for patients that he sees in rural America.

And so, I've always had a little bit of trouble understanding why we would have a different set of rules here based on a concern that other companies have indicated to me is something that they have been able to address. It's also important, I think, to remind ourselves that this is a multi-trillion dollar market.

In my experience working with industry in this and other contexts, I have learned that smart leaders can and will adapt to serve changing conditions. Many industry players already have a model, as I have indicated, in place, that puts their clients' interests first. And I believe our rule-making can serve as a catalyst for further innovation in the industry, as more firms devise new models and strategies, assisted in no small measure by modern software and other technology-based tools to

accommodate even those with only a few thousand dollars to invest.

I'm very proud of the way that we, at the Labor Department, have been approaching this rule-making. At every step of the way, we've taken an inclusive and careful approach, and I believe that the final rule will be stronger for that. Given the importance of the matter at hand, we've proceeded with the utmost caution and deliberation.

We've been at it now for roughly five years, and when I became secretary, a little bit more than two years ago, I made a commitment to slowing down the process so that we could get it right. During my confirmation process, I heard a considerable amount about the need to proceed carefully, and we have done just that.

We've built a big table. We've invited everyone to pull up a chair. Our approach has been one of a keen air, an open mind and a healthy dose of humility. We didn't just check boxes, go through motions and pay lip service to people's views. We listened. We listened in 2011, when we heard from many stakeholders that our initial proposal was flawed. And so, we withdrew it and went back to the drawing board.

We listened throughout the last few years, as we solicited input from the broadest possible range of stakeholders. Financial industry groups, financial services firms, large, small and in between, companies offering retirement plans to their employees, consumer groups, civil rights organizations, academics and so many more.

Our outreach even took us across the pond. I travelled personally to the UK, to listen and learn from the UK regulators about their experience and about their approach to this challenge. We also listened attentively to our colleagues at the Securities and Exchange Commission, whose expertise and assistance were very important to the completion of a sound proposal.

With the partnership with the SEC was important and helpful, we believe, and SEC Chair White agrees, that the labor department is well within its jurisdictional authority in proposing this rule, and that there is no need for us to wait for the SEC to ask first on these questions.

Former SEC chair, Arthur Levitt, also agrees. Calling hours a, "balanced proposal," he said further, and I quote, "I don't think we can afford to wait to implement the fiduciary standard. It started the Labor Department, and that's where it should end, to get it on the books before it's too late."

We appreciate the substantial input we received from the SEC, and there are examples of their input throughout our proposal, and the questions we asked, as well as the way we crafted the proposal. By way of example, our definition of best interest directly adopts a standard set out in the 2010 SEC's own staff report on a best interest standard.

At the same time as Chair White has herself publicly recognized, we are two different agencies pursuing two different statutory mandates. Because we listen to all of the stakeholders, and because our outreach was as robust and comprehensive as it was, and because we captured a diversity of voices and views, I believe that the process produced a very pragmatic proposal that people can respond to.

So for instance, having heard from industry how disruptive such a step could be, we did not propose a ban on commissions, such as the one in the UK. Large plans with sophisticated fiduciaries made the case that they needed greater flexibility in dealing with advisors. So, we included a seller's carve out for them in the proposal.

In response to other feedback, we further clarified the line between financial education and advice in our proposal, so that employers, call center employees and other financial professionals will preserve their rights to provide general investment education without becoming fiduciaries.

Commenters on our original proposal wanted to see the exemptions, as well as more rigorous economic analysis. So, our new proposal contained a significantly more rigorous economic analysis, and we proposed exemptions at the same time as the rule. Of course, the release of the proposal, and actually, there was one other example I wanted to provide.

Some stakeholders were concerned about a provision in the 2010

proposal pertaining to Employee's Stock Ownership Plans, ESOPs. And you will note, if you look at our current proposal, that that provision is not part of the current proposal, and that's a result of the listening and learning that we did in that proposal.

And so now, as you know, with the proposal having been released, we now entered another phase of the process, and that is, another phase of listening and learning. And we've spent roughly the last six months listening to the feedback about the proposal, taking more than a hundred meetings with stakeholders of all kinds, and I've testified in both the House and the Senate.

When people have said they needed more time to review the proposal, we listened again and extended the comment period by a few weeks. We will continue. In August, we had four days worth of hearings, and those hearings were very, very invaluable, and we opened the floor to an array of perspectives. The second comment period remained open until September the 24th, giving everyone plenty of time to review the transcripts from those hearings.

This has been one of the most longest comment periods of any rule that I have been involved in; almost six months, on top of the period of 18 months or more of informal outreach that we've done. All told, the number of comments and petitions received on the rule and its exemptions comes to 391,621, for those keeping count.

We're now spending the months ahead evaluating all of the comments and giving them full consideration. There have been many constructive suggestions for improvements. Among many other things, we've heard concerns about potential burdens associated with the point of sale disclosure, data retention, and the mechanics of implementing the best interest standard.

I can't say right now exactly what the outcome will look like on these issues, or any other comments or suggestions that we have received, but I am confident that we will be making changes to improve and clarify our proposal, addressing legitimate concerns that have been brought to our attention. That is precisely what notice and comment rulemaking is all about.

At the end of the day, I'm confident that we'll come out of the process, which has been extraordinary in its openness and its breadth of dialogue, with a strong balanced rule that protects both consumers, while providing a sound business climate for financial advisors.

Over the last six years, the nation has experienced a remarkable economic recovery. Unemployment, which had climbed up above 10 percent, is now back near 5 percent. We're in the middle of the longest streak of private sector job growth on record; 32.5 million jobs over 67 consecutive months.

But in so many ways, the economy is still out of balance. While we've put the great recession in the rear view mirror, while we're no longer experiencing the kind of financial meltdown that wiped out so many people's hard earned life savings, still, millions of people are struggling to find the economic stability they need, and the economic stability that they've earned. And the current outdated regulations governing retirement advice are contributing to that instability.

To create shared prosperity in an economy that works for everyone, we need to make this fix. To ensure that working families don't spend their golden years burdened by economic anxiety, we need to give them the assurance that their financial advisor is putting their interest first. If we don't, then we're not holding up our end of America's basic bargain; the promise of retirement with dignity after a lifetime of work.

President Obama has spoken frequently and eloquently about the five pillars of middle class in America; a good job that pays a family sustaining wage, an education that gives you the skills and knowledge you need to succeed, a home that provides a safe roof over your head, and perhaps, even allows you to build a little bit of wealth, affordable healthcare that's there when you need it. But you can have all of these through your prime working years, only to see them eroded, unless we've strengthened that fifth pillar: Saving for your family's future and working toward a secure retirement.

The conflict of interest rule is one of the most important steps we can take to fortify that all-important fifth pillar. I am grateful, again, to all of the people who

have engaged with us on this critical question, who have brought so much insight and expertise to the big table that we've constructed. This one of my top priorities as Labor Secretary, and it will remain so through the final 462 days of this administration.

Thank you so much for your time, and I look forward to your questions. And I want to thank Josh Gotbaum, who had a distinguished career at the BBGC, for moderating our Q&A. Thank you very much. (Applause).

(Break in recording)

MR. GOTBAUM: -- the dictates of transparency and technology being what they are. As Martin has pointed out, disclosure matters. So, I should disclose the fact that the Secretary of Labor, when I was running the Pension Benefit Guarantee Corporation, was my board chair (Laughter).

SECRETARY PEREZ: By statute.

MR. GOTBAUM: Yes, by statute. Yeah.

(Break in recording)

MR. GOTBAUM: As a result, I have some idea of the time constraints that you are under, and my understanding is that there are -- our time is limited, so let me go straight --

SECRETARY PEREZ: Just jump right in.

MR. GOTBAUM: -- straight into questions.

SECRETARY PEREZ: Good.

MR. GOTBAUM: Mr. Secretary, you made the point that in deciding what to do in your proposal, this time, you had the example of Britain, which --

SECRETARY PEREZ: Mm-hmm.

MR. GOTBAUM: -- which for those in the audience who don't know, Great Britain considered this same conflict of interest rule, and decided, more or less, to prohibit any kind of product related compensation.

(Break in recording)

MR. GOTBAUM: You and the department didn't go that far. You said

there could be an exception, as long as there was a best interest contract.

SECRETARY PEREZ: Mm-hmm.

MR. GOTBAUM: Could you talk a little bit about your -- what led you to decided not to go as far as Britain? And I should mention, other countries have done the same thing.

SECRETARY PEREZ: Sure. Well, we were listening to the feedback we got, Josh, and we got a lot of feedback to the effect that banning commissions was a bridge too far, and that banning commissions could have unintended consequences.

I traveled to the UK because I wanted to kick the tires for myself. And what's interesting about the UK experience is that when you look at the entrance into the market, now that there has been time, and you compare it with those who have left the market, the entrance into the market has far exceeded those who have left the market. That's counter to what I had been hearing. That's why you've kind of got to go out there and talk to people for yourself.

And so, it's interesting to look at their experience, but at the same time, we again, wanted to make sure we listened and took into account that sort of feedback here. So, that was a judgment that we made in this proposal, and we've obviously got a lot of comment on that, and we're in the process of reviewing all of those comments now.

(Break in recording)

MR. GOTBAUM: I've got a question about timing. This has been an issue, as you've said in your talk --

SECRETARY PEREZ: Yeah.

MR. GOTBAUM: -- for years.

The department proposed something in 2010, withdrew it in 2011, and then, proposed it again in 2015. What dictated the timing? What made you decide to move now?

SECRETARY PEREZ: Well, as I said, during my confirmation hearing, I made a pledge that we would take a very careful approach. And we did just that. And

so, some of my first meetings when I got confirmed, were about this issue.

I've probably done more outreach to external stakeholders on this issue than any other issue that I've worked on as labor secretary. I've met with CEOs of major companies. I've met with leaders of consumer groups. I've met with academics and others, because I wanted to make sure I had a firm handle on this.

And as a result of that informal outreach, we learned a lot. And I outlined in my remarks, the changes that we made in this re-proposal from the earlier remark -- from the earlier proposal of 2010. Why now? Frankly, now is too late for the Tofulls. The Tofulls were a family I met during the course of my outreach, and their story breaks my heart, because he did everything right.

He was a war veteran. He had a distinguished career in the trades. Worked hard to save a nest egg of like $600,000. He managed his own accounts. Then, when his wife saw that he was beginning early stage Alzheimer's, she went to her local bank, and she trusted them. And the advice they gave them was arguably suitable, but the advice was horrible.

And as a result, the variable annuity that they were put in, and then, the money they had to pay to get out of that variable annuity in the aftermath was significant. And for them, you know, frankly, it's too late. And so, when we have conversations about timing, we have to make sure that we've been listening, and I believe we have, and that's why we've taken as long as we've taken.

But we have to be mindful of the fact that for many people, the clock has been ticking significantly, and the consequences of doing nothing have been, in the case of the Tofulls and others, rather catastrophic.

(Break in recording)

MR. GOTBAUM: You have made the point, eloquently, that there has been lots of rethinking to make this proposal, and lots of consultation since this proposal, and that you are still thinking about that. To the extent that you can -- we understand that you're in a period of decision making -- but to the extent that you can, talk a little bit about

the areas that have been ranged -- that the department is considering revisions in.

SECRETARY PEREZ: Well, I can't really get specific on that because of where we are in the rulemaking. What I can say to you is this: We've gotten a lot of comments in a lot of areas, and we take all of those comments very seriously, and we have a remarkable team of dedicated people working on this. And they know their stuff.

You met a number of them, to the extent that you participated in the four days of hearings. You saw the professionalism of the dedicated staff at the Department of Labor. And I've had the privilege of working on a number of rules during the course of my career, both in federal and state government, and challenging rules -- rules in which there were honest and very heartfelt and passionate differences of opinion. And we've been able to thread those needles because we listened and we learned.

And I've said a number of times about how you know, the North Star in this proposal is an enforceable best interest standard. It's kind of a Ronald Reagan rule. Trust by verify. You know, your marketing material says that you put your clients' interests first. This proposal says that you now have an enforceable obligation to do what you're saying in your marketing materials.

And what we've heard in the feedback is there is a more linear path to get there, and there are consequences that you may not have considered. And our response to that is, give us that more linear path. Tell us about the consequences, so that we can better understand that and take them into account. That's why the comments have been so invaluable, and that's why the public hearings, the four days' worth, were incredibly insightful for us. And so, that's what we're doing right now.

MR. GOTBAUM: One of the suggestions that has been made to the department was to focus on the rollover from a 401K to the IRA. As you mentioned in your talk, this is a large amount of money affecting a large number of people, et cetera. And one suggestion that was made was that the department focus these regulatory changes first, on those actions. Is that the sort of thing that the department can consider in your decision making?

SECRETARY PEREZ: Well, the whole rollover issue is an issue that has generated a lot of understandable attention, questions and concerns. And we were aware of that. And this is an important issue, because of the volume of rollover.

And I can't really get specific on where to go, other than to say that we've got a lot of very, very thoughtful comments across an array of opinion spectrum, and we are reviewing every single one of them very carefully to address this issue, because this is a very, very important matter that you bring up, and we recognize that, and that's why we asked a lot of questions about this. And this was an issue that certainly came up in the public hearings that held, as well.

MR. GOTBAUM: Your time is short, but let me ask one more. The whole notion of the best interest contract is -- everybody understands why it's proposed, and the department has made it clear that the structure and form of this contract is one of the things that is being considered on which you've received some very large number of comments.

Can people expect that even after a final rule is promulgated, that there will be some ongoing process of revision or learning, as people learn more, in the guidance that you provide as to what ought to be in that contract?

SECRETARY PEREZ: Well again, we've heard a lot of feedback on this. This was certainly one of the areas where we heard quite a bit. And again, what we heard from many people was, we agree that there should be an enforceable best interest standard. We think there's a more linear path.

And our answer was, show us your opinions on how we build a more linear path. And we've gotten that feedback, and that's exactly what we're taking into account. When this process reaches its conclusion, then you know, at that point, you know, there are a number of other issues that emerge. And you know, throughout that, you know, I think it's very important for us to make sure that we're moving thoughtfully and carefully.

And this is not the first complex rulemaking that I've been involved in,

and we've always aspired to make sure that we were careful from the outset of our initial outreach before our proposal, all the way through the period of time including the publication of a final rule and the implementation and the outreach and technical assistance that comes with that implementation in other rules.

Our teams and other contacts -- we're doing a home healthcare rule right now that was the subject of litigation. That litigation is now effectively over. The D.C. circuit upheld our rulemaking there, and the mandate was issued quite literally, I think earlier this week, or it will be issued in the imminent future.

And throughout that portfolio, we were working with stakeholders to make sure that we can all work together, because you know, our goal is to help everyone comply. Our goal is not to try to engage in sort of the gotcha game of here's the new rule, and you didn't comply, so we're coming at you with our ticket book. Our goal is at the outset, to help facilitate compliance in that context, and I think that's the appropriate way that you should go about any rulemaking.

MR. GOTBAUM: Terrific. We would, of course, like to ask several dozen questions and ask more, but part of the reason why this event started when it did is that the secretary has two more obligations, one of which starts in two minutes. So with that, let me thank you very much for coming and talking.

SECRETARY PEREZ: Thank you.

MR. GOTBAUM: And we look forward to seeing the results.

SECRETARY PEREZ: And thank you again, to everybody, for your input in this process. Everybody has been really, really helpful. Thank you. Thank you, Josh (Applause).

(Break in recording)

MR. BAILY: Could everybody please remain seated until the secretary leaves?

SECRETARY PEREZ: Great. Great to see you. Bye, bye.

(Break in recording)

MR. BAILY: Thank you. We're now going to have our first panel, and both panelists are going to present some slides, so I'm going to ask Sean Collins to come up first, and I'm going to give his introduction. And I'm going to introduce Jane Dokko now, and then we can sort of roll right through.

So, Sean Collins is the senior director of industry and financial analysis, and heads the Investment Company Institute's research on the structure of the mutual fund industry. Jane Dokko is a fellow in economic studies and policy director for the Hamilton Project. Previously, she worked for the board of governors of the Federal Reserve System and for the Council of Economic advisors. All right? So, Sean, can you come up? And I think your slides up there on the --

(Break in recording)

MR. BAILY: Are you going to speak from the --

MR. COLLINS: Yeah, if that's okay. Yup. So, thank you, Martin, and I appreciate the opportunity to be here. So first off, let me say that ICI and its members agree with the Department of Labor that financial advisors should be held to a best interest standard, and we've been sympathetic to the DOL's efforts to revisit and reform the 40 year old fiduciary rule. So, get that right up front.

But the devil is in the details. Unfortunately, there are many specifics of the DOL's proposal that will be highly costly and in many ways, unworkable. ICI itself and other members of the ICI suggested a number of changes to address those problems in our comment letters to the department. What I want to focus on here, though, is the DOL's cost benefit analysis, which must demonstrate large benefits, because there are high costs to the rule. Unfortunately, the DOL's analysis doesn't pass that hurdle.

Okay. So, the DOL's cost-benefit analysis, which claims massive benefits from its proposed rule, an estimated $17 billion a year, is fundamentally flawed. In my view as an economist, these numbers are simply drawn out of thin air. Here's some of the key problems with their study. First, the DOL's analysis relies heavily on academic studies that use data from the 1990s and the 2000s.

Fifteen to 20 years ago, however, the fund market was segmented with little direct competition between broker sold funds and direct sold funds, no load funds. Some of the academic studies that the DOL relies on argued that this segmentation led to weaker competition, producing subpar performance for some front load funds. But since then, fundamental changes have happened in the industry, and direct competition has emerged between load and no load funds, for example, as traditional broker funds added no load share classes sold through discount brokers and fee-based advisors.

Because of this change in the competitive environment, rather than relying on academic studies that use data going back as far as into the 1990s, the DOL should have conducts its own analysis using publicly available current data.

Second: The results in those studies typically apply to the performance of individual funds, rather than the experiences experienced across the entire economy of all investors. I want to emphasis that none of the studies that the department relies on reaches a conclusion about costs or benefits across the entire market. The department, however, tries to use those studies to reach exactly that kind of a conclusion, but in doing so, it makes mistakes.

For example, it takes a single front load fee that happens to be a fairly high front load fee, and uses that as a proxy for the front load fees incurred by all investors in all IRAs -- sorry, in all broker sold IRAs, which in some sense, is equivalent to predicting total gasoline consumption in the U.S. by applying miles per gallon to a Hummer, to every vehicle in the U.S. It simply doesn't make sense.

Third: The department didn't need to rely on academic studies. What it could have done is gone out and got publicly available performance data and measured investors' actual experiences in broker sold funds, which means weighting fund performance either by fund sales or assets. So, suppose the department had done that. What would it have found?

Well first of all, again, the department and the Council of Economic Advisors claimed that broker sold funds underperform by 100 basis points per year, 1

percent. Never much discussion about what underperformance means; what it's relative to. But here are some examples of what underperformance might be measured as.

If you compare the performance of broker sold funds to their Morningstar averages using recent publicly available data, what you would find is that broker sold funds outperformed their Morningstar category averages by 27 basis points. Of course, there are many ways to measure fund performance.

Another way is to compare broker sold fund performance to that of no load funds, using recent data and adjusting for the advice that investors pay for through broker sold funds, broker sold forms (sic) in this case underperformed slightly by .07 percent, 7 basis points, which is fully 14 times less than the number that the DOL assumed. Again, this is publicly available data, so to me, it seems hard to deny.

Next slide. If the DOL proposal is adopted, it could shut millions of IRA investors with smaller balances of moderate means out of the advice market. The left hand pie chart up here shows that 76 percent of IRA accounts, everything other than the green shaded area, have balances of less than $100,000.

IRA accounts -- the remaining green portion, 25 percent of IRAs that have balances greater than $100,000, which is over here in the pie chart on the right hand side, the green area, have most of the balances in IRAs, 81 percent of the balances. Okay?

(Break in recording)

MR. COLLINS: So, for those investors that have small balances in IRAs, they may be shut out of the advice market, simply for the reason that fee-based advisors often require minimum balances of a hundred thousand dollars or more. So, those investors over there with smaller balances, could simply lose advice that they could get from a broker under the current arrangement.

The right hand pie chart, again, these are people that may be using brokers -- brokerage based advice costs about 50 basis points per year right now. These investors, if they are forced -- if they want to continue to receive advice, and they are

forced to move to fee-based advisors, they will probably pay more. Fee-based advice on average right now costs about 112 basis points per year. That's publicly available information.

Okay. So, where does all of this leave us? We estimate that the department's proposed rule, if adopted as currently structured, will cost IRA investors 109 billion over the next 10 years. How did we get to that number?

If we accept that broker sold funds underperform by seven basis points, that's the plus $8 billion number there, the rule provides a little bit of a benefit -- $8 billion over 10 years. But that's more than offset by performance losses that IRA investors incur for other reasons. First of all, 55 billion, one is that IRA investors with balances greater than a hundred thousand dollars, if they want to receive advice, shift or assume to shift from brokers to fee-based advisors, pay more for advice to the tune of $55 billion over 10 years.

A second reason is that IRA investors with balances smaller than $100,000, the $62 billion number, who now use brokers, could get shut out of the advice market because of minimum balance requirements, and left to their own devices, could make costly financial mistakes, which we estimate would cost an estimated $62 billion over 10 years. On net, the rule ends up costing IRA investors a hundred and nine billion dollars over 10 years.

In sum, we support a best interest standard and the department's decision to revisit the 40 year old fiduciary rule, but the proposal, if adopted as structured, could be very costly for small retirement savers of modest means. Thank you.

(Discussion off the record)

(Break in recording)

MS. DOKKO: Great. Good afternoon. Thank you for the opportunity to speak today. I'm pleased to be here, and I will be speaking on behalf of myself, and not anyone else. Could I have a little help with the AV?

(Discussion off the record)

(Break in recording)

MS. DOKKO: Okay, thanks for waiting. I'm going to be talking about two issues. One: Whether there is evidence that conflicts of interest in financial advice are systematically and adversely affecting retirement savers. And two, how research analysis can generally help inform this question, elevate the debate that's been going on and provide better answers.

My perspective on these issues comes from my academic training as a researcher, not as someone who has worked for the financial services industry, a litigation consulting firm or a consumer advocacy group. And in the interest of full disclosure, I was a senior economist at the Council of Economic Advisors and worked on the CEA's report on conflicted investment advice. As the secretary discussed, this study concluded that conflicts of interest cost retirement savers approximately $17 billion per year.

To make sure that we are all on the same page about the questions under consideration, here is a list. First, we want to know whether advisors tilt their recommendations when they receive higher payments for recommending certain products over others. We also want to know whether these recommended products underperform or erode investor's savings.

Put somewhat differently, we want to know whether the incentives that brokers base caused bias advice and underperformance for retirement savers. Sean highlighted one set of answers to these questions. Let me present another.

A range of studies demonstrate that conflicts of interest and conflicted advise are observed in real world situations. First, two mystery shopper or audit studies demonstrate the bias in advice stemming from the incentives that advisors face. Researchers from Harvard, the University of Hamburg and MIT, sent auditors to financial advisory firms in Boston and New York.

These auditors presented themselves as already having an account and were shopping around to open a new account. They were very similar in their

characteristics, such as their investment horizon, account balance, risk tolerance, and so forth, and on balance, they differed only on the type of portfolio they presented the advisor. Some of them had a portfolio invested in index funds. Others had cash, and others were invested in company stock. The researchers found that the auditors were systematically steered away from well diversified investment strategies and toward funds that were in the economic interest of the advisor.

Another mystery shopper study approached advisors with a TSP account. This is the Thrift Savings Plan for federal government workers. The TSP is an extremely low fee account and offers a menu of carefully selected investment options. Here, the mystery shopper was asking about whether he should roll over to an IRA, which would have had higher fees, or keep his investments in the TSP account. In all instances, the advice was to encourage the rollover, even though it would have certainly increased the fees and not necessarily provided higher returns.

A range of other studies document bias and underperformance stemming from conflicts of interest. Susan Christopherson and coauthors isolate the incentives that brokers face and find that these incentives leave brokers to tilt their recommendations toward funds that provide them with larger incentives. In the case where the incentives come from load sharing with the broker, the authors find that the recommended funds underperform on average by about 115 basis points annually.

Other studies point to similar sources of bias, and even -- and similar or even larger magnitudes of underperformance. For example, research finds that broker advised accounts are heavily tilted toward the investment options paying the highest annual commissions. What's nice about this particular study by John Chomerce and John Reuter is that their data allow them to control for differences in the observable characteristics of those in broker advised accounts versus those who are not. So, their results are unlikely to arise because of other confounding factors.

This research also finds that broker advised accounts underperform a counterfactual portfolio of target date funds by over 200 basis points. Another study

shows how flows into broker sold funds respond to raw returns on commissions rather than to risk adjusted returns. This result provides evidence that brokers respond to incentives. Moreover, such funds underperform by over a hundred basis points, relative to index funds.

In addition to the evidence listed here, studies looking at accounts in Canada, Germany and Switzerland find that broker's incentives lead them to tilt their recommendations, and that investors are steered toward underperforming assets. To be very clear, the institutional and regulatory environment for financial advisors is different in other countries, but these studies are aiming to isolate the role of incentives and to determine the effect of incentives on advisors' behavior and the consequences of their recommendations for savers.

Turning to the second issue that I'd like to talk about, as a researcher, one of my aspirations for research and analysis is to elevate the policy debate. And I firmly believe that this can happen, but only with the proper application of sound methods. Sean presented one set of analyses. I presented a different set of results, and I would encourage researchers on all sides of the discussion to strive toward the following six goals.

For one, research needs to carefully measure and isolate the role of conflicted advice or conflicted incentives, and how these vary across advisors, and how the variation of these payments lead to different outcomes for different types of savers. And this means that one would need to draw inferences from all else equal or (Inaudible portion) comparisons, so just when you compare two groups of accounts or funds that differ only in whether the advice is paid for through conflicted payments or through other methods. Otherwise, you run the risk of contaminating the comparison with confounding factors. So, just the characteristics of the account holders that could explain any difference in performance or other outcomes.

One way to isolate the role of conflicted advice is for researchers to apply pre-specified research methods that have a credible source of identification. This

means that without looking at the data, a research needs to explain the analysis that he's going to do, how he's going to isolate the variation and the conflicted advice and the hypothesis he expects to test, based on the results he will obtain.

This element of research is critical to prevent researchers from data mining; that is, from running a bunch of different econometric specifications until he finds the answer he's looking for, or from cherry-picking favorable results, and presenting only the ones that bolster his case.

A third goal for research and scholarship is that results need to be replicable. By replicability, I mean that the results should be consistent across a range of datasets when the same pre-specified research methods are used. And researchers should share their data and their code that they used to obtain their results, so that others can easily replicate their analysis and results.

Fourth, research also needs to promote transparency about the statistical precision of the results. As many of you know, in statistical and econometric analyses, sometimes you can get results based on chance, and the purpose of standard errors in estimating margins of errors to rule out whether the results you are showing arise due to chance. And standard errors are also necessary to rule out very small or very large effects.

Fifth, a defining feature of scholarship is to demonstrate that a critique is valid, not just to poke holes in the existing literature or the available evidence. So, research should aim to sign the bias; that is to do the analysis and to conduct the scholarship to demonstrate that a criticism of the available evidence is true, not just to criticize, use innuendo and arguments or make blanket assertions.

And lastly, I would like to encourage all researchers to consider and balance all of the evidence that meet these criteria, and in doing so, to discount the shortfalls in the evidence with the appropriate weight. After all, all research is imperfect, but some problems are bigger than others.

Going forward, I want to press on all sides of the debate to promote high

quality of research and analysis on the research questions presented earlier. The economics profession has the tools to answer these questions. Importantly, researchers should promote replication. I'd encourage Sean and others who are actively engaged in finding answers to their research questions under consideration to share their data and to share their code.

In the cases were publicly available data are being used, that's great. You know, all you have to do is post the code. If anyone in the audience can promote the sharing of account level data and data that carefully measures advisors' incentives, I would be happy to put you in touch with unbiased researchers who have no ties to either side of the debate, who are interested in analyzing such data and are eager to do so.

As many of you know, disagreements amongst scholars are common and well documented in peer reviewed journals, and to promote scholarship, I would encourage those who disagree with peer reviewed results, including those I discussed earlier, to engage in the scholarship to refute those conclusions. And there are many journals and many journal editors eager to publish high quality research on all sides of the debate. So, thank you for your attention. I look forward to the conversation.

MR. BAILY: Thank you.

(Break in recording)

(Applause)

(Break in recording)

MR. BAILY: So, now we're going to have -- thank you -- a discussion. I am going to --

(Break in recording)

MR. BAILY: Excuse me. I am going to ask the audience to ask questions, so, please prepare your questions and I will then call on you. But I'm going to start off with a couple of questions for you guys.

So, Jane has presented some studies here, some peer reviewed journal articles, including the mystery shopper one, where they sent people around to brokers

and said, so what should we do. We have a portfolio. We have this much money. Maybe here's what we're doing with it now, or maybe it's in cash, and then, they assess what the answers were that came back from the brokers.

Are you familiar with those studies, or do you have any comments on the validity of that -- what you see coming out of those studies?

MR. COLLINS: Well, yeah. I mean, surveys are fine. You know, economists generally are very cautious about reading general results into results from surveys, for any number of reasons. But I think the main point is, whatever you find in a survey, the question is, what's going on economy wide?

MR. BAILY: Was it a survey? Or this was experimental evidence, wasn't it?

MS. DOKKO: That's right. It was experimental.

MR. BAILY: Experimental evidence, essentially.

MR. COLLINS: Same issue. Survey design is important in both experiments and surveys. So, the key question -- the point that I'm trying to make is that -- what the department needs to do is measure costs and benefits across all IRA investors, across the economy. And you're not going to get that by going and looking at, you know -- doing a mystery shopper survey in a single shopping mall.

What you need to do is go get the actual numbers on what investors paid, how investors performed. Add that up across the economy and see where you come out. And that's what I tried to show in my presentation, is that if you do that -- you know, and again, there are various ways to assess that, but you do that, and you know, it's not obvious that there's a systemic problem here.

MR. BAILY: Okay, Jane, so let me throw that argument back on you. So, if you look across the whole range of assets and the numbers that Sean presented here, showing a relatively little penalty from owning these broker seller funds. How can that be true, if what you said, the experimental evidence is right? What's -- how are these --

MS. DOKKO: What's going on?

MR. BAILY: Yes. What's going on?

MS. DOKKO: So, I guess you know, I don't fully know what's going on, because I don't know how precise -- how exactly these numbers were churned and things like that, and I'd love to learn more about the methods that were used in order to estimate the numbers that Sean showed earlier.

But I think what's critical is that any comparison of broker sold funds versus something else, they have to tie the performance to the conflicted advice. Right? And that's what was missing in that. And so, they needed to show -- like the analysis needed to show that there was, you know, some element of exogenous variation in sort of the conflicted payments, and that the two sets of you know, assets were otherwise sort of similar, and the conflicts are -- you know, what's driving and generating the results.

And so, it's hard to jump from you know, say comparing investor and broker sold funds with you know, their respective Morningstar returns or you know, comparing the performance of you know, broker sold assets with fiduciary accounts. Like how to infer what the magnitude of the problem is from there -- from that comparison.

MR. BAILY: But if you look at all the assets that people are holding from broker sold funds, doesn't that give you what an average error would be? And can the bias be any worse than the amount he is describing?

MS. DOKKO: Well, it's depends on what's in the counterfactual. Right? And I don't know what's in the counterfactual with sort of Morningstar averages.

MR. BAILY: Okay. Let me press you on another question, and then I'll come back to Sean. So, one of the things that advisors do -- or I should say one of the things -- one of the advantages that advisors offer is potentially to avoid people who invest for retirement pulling their money out too early, or not saving enough.

Now, aren't there some positive incentives there? If you're selling funds, you want the people to put more money in. Right? And you know, isn't there a tendency for people not to save enough for retirement? So, is that a positive bias that's going to

help and make advice more valuable?

MS. DOKKO: I need to be clear. There are many benefits of advice. The question is whether one needs a commission structure such as the one that we have today, in order to reap all the various benefits of advice, such as you know, market mistiming and you know, the inability to save. Right?

And I think there are many views on this. Many different business models have different perspectives and answers. And so I hope that everyone in the audience stays, you know, until the next panel, to hear the range of views on this question. But you know, I think the thing to keep in mind is, you know, you have two groups of savers, and one -- they're both receiving advice.

In one instance, you know, the advice is being for through differential compensation for the advisors for recommending certain products for -- you know, over others. And then in another instance, the advisors are still being paid, but they're being paid in a manner that doesn't create these sorts of conflicts of interest.

And so, you're sort of holding constant the benefits of advice. And I think that at least in my interpretation of the evidence, it's very clear that there are certain conflicts of interest, and that you know, those conflicts matter for savers.

MR. BAILY: Okay. Can you give a response to that?

MR. COLLINS: To which part?

MR. BAILY: (Laughter) The argument was -- the counter argument was being made that it wasn't clear what hypothesis, exactly, you're testing by presenting this evidence of the returns.

MR. COLLINS: Sure.

MR. BAILY: Okay.

MR. COLLINS: So, I think again, the charge that the DOL made in their analysis was that broker sold funds were underperforming. So, what we're doing is pretty simple. We're trying to go out and use current data and figure out if we can see if broker sold funds are underperforming.

We do that. We do that various ways. So, as I said before, to measure underperformance, you have to use some kind of a benchmark. So, there are any number of benchmarks that you could use. One of the benchmarks that we used was Morningstar averages. One of the reasons that we did that was one of the key studies that the department used in its analysis compares broker sold fund returns to Morningstar averages.

MR. BAILY: Okay. So you're saying you did the same thing that DOL was doing --

MR. COLLINS: Yeah.

MR. BAILY: -- in order to --

MR. COLLINS: Yeah. We were trying to check what they were doing.

MR. BAILY: And you got a different answer than they did?

MR. COLLINS: Well, they didn't actually get an answer. What they got was a coefficient -- a regression statistical coefficient, in the jargon of econometrics, from a journal paper. The DOL didn't actually go out and measure underperformance on their own, which is what we think they should have done.

MR. BAILY: Have you made any --

(Simultaneous discussion)

MR. BAILY: I'll give you a chance to come back.

MS. DOKKO: Okay.

MR. BAILY: I'm just going to try to be evenhanded here. What about the issue of other kinds of advice, apart from just what asset you buy? What about this issue of how much people are saving and so on? Have you guys looked at that part of the investment advice issue?

MR. COLLINS: Well, I think there's -- you know, there are surveys out there. We have done various things that suggest that without advice, people tend to make mistakes. And so, the department itself makes that point any number of times. And mistakes can be quite costly.

The question is, if you take away from investors the ability to access a broker, especially small investors who are more likely to go to a broker because it tends to be cheaper for them, do you disadvantage them in a way such that they start making exactly these kinds of mistakes? So, for example, there are rules, I believe, for rollovers, where a company may roll -- if an employee leaves the company and there's a 401K balance, and the balance is rather small, the company has the option of rolling them out of the 401K.

The default option, I believe, is a money market fund. So, if you don't have a broker assisting the investor at that point, they may -- and we see this a lot in the data -- just leave the money in a money fund, sitting there for years.

So now, the returns on money funds these days are like basically zero at the moment, compared to -- okay, bond funds, 2 to 4 percent, equities, you know, hopefully, 5, 6, 7 or more. So, that's a huge loss. There are other things that can happen, too. For example, you can make mistakes with required minimum distributions from IRAs. You make mistakes, you pay a tax penalty. You're much less likely to do that if you have an advisor helping you.

MR. BAILY: Okay. So, what -- do you have a response to that? I know you were gearing up to give a response.

MS. DOKKO: (Laughter)

MR. BAILY: So, let me give you that chance.

MS. DOKKO: Not sure whether I was gearing up for a response, but I guess I have a different interpretation of what the DOL is saying. And again, this is my interpretation. I'm not speaking for anyone except myself. But my understanding is that the assertion is not so much that broker sold funds underperform, as you have said, but it's that broker sold funds underperform because of conflicts of interest.

Now, that's a slightly different assertion, because in order to support that claim, one needs to you know, identify the cause, and you know, identify why there is variation in conflicted payment. And then, tie that to various performance outcomes or

outcomes for -- other you know, sorts of outcomes for savers.

And now, you know, the analysis that I would love to see is you know, not so much the comparison of broker sold funds against a benchmark, but a comparison of broker sold funds and the variation in sort of the conflicted payments that -- you know, that arise in those funds, and whether funds with larger you know, elements of conflict or advisors with larger elements of conflict cause you know, more tilted recommendations or more biased advice or more underperformance.

And so, that's why they rely on the academic studies, rather than going out and you know, making various like comparisons, as Sean and others have done. There's a causal statement there, and in order to establish the causality, they're turning to the academic literature that has looked at -- you know, and has identified exogenous variation in the magnitude of the incentives that the brokers face, and tied the incentives to the outcomes for the funds and the savers.

MR. BAILY: How about some questions from the audience?

(Break in recording)

MR. BAILY: Yes, we have a question there. There are mics coming around, so please identify yourself. Please try to make it a short, pithy question.

MR. MEYERS: It's Donald Meyers. The question is for Jane. As I recall, the CEA study concluded that there were billions of dollars that were lost as a result of conflicted advice. And that number was tattered by CEA and Department of Labor, as well.

And one of the arguments that was made, as I recall, was that it took -- it looked at rollovers, and it assumed the typical 401K investor invested in funds that -- index type funds that had very low fees, rolled over into funds that charge much higher. The differential times and number of people involved came out to 20 or $40 billion. Since the typical 401K investor may not be invested in index funds, wasn't that number kind of substantially exaggerated?

MS. DOKKO: So, I guess I want to clarify what was in the report, in

response to that question. So, I believe some of the criticisms were directed at a particular table in the report. And my recollection is that the table was meant to just highlight one particular example. It was meant to be illustrative of one case of how an investor could lose, you know, some amount of because of conflicted advice in sort of the rollover context.

But when the report considers what the estimates would be, sort of in the aggregate, it turns to you know, the academic literature and the interpretation of the academic literature, and a sizing of the assets that are you know, in question. And so, I think the two are separate pieces, and the aggregate estimates of you know, $17 billion were not informed by the sort of hypothetical example that you cited in the rollover context.

MR. BAILY: Do you have a comment on that, or should we move on to the next question? I want to give you an opportunity.

(Break in recording)

MR. COLLINS: Well, I think the particular table that you're talking about -- I think there is a fundamental problem with what the department did. I'm not sure it's quite what you're describing. It's more related to the fact that again, as I sort of alluded to in my comments, in that particular table, essential what they do is, they take you know, the gas mileage consumption of a Hummer and they say you know, we're going to apply that to every single car in the U.S., and we get huge gas consumption. I think in that particular table, if I understand which one you're talking about, is effectively what they did.

MR. BAILY: Okay. We have another question at the back.

MR. NAYLOR: Hi, Bart Naylor, Public Citizen. The short version of my question is, I hope that each of you will utter a sentence that includes the name Robert Litan in it. And the longer version of my question is that there's a certain symmetry that we're talking about -- conflicts of interest that brokers who are paid a commission to promote one versus another type, might lead to an adverse result for the recipient of that

advice, and the concept that economists -- others under the banner of prestigious universities might have their advice skewed by that monetary compensation. Thank you.

So, the only requirement is that your sentence has to include at some point --

MR. BAILY: No, I'm going to rule that out of order. I don't -- this is not the situation where we want to have a discussion of Bob Litan. Is there another question? Yes?

(Break in recording)

MR. OTTMAN: Hi. Mike Ottman with Consumer Federation of America. My question is for Sean, and it has to do with ratcheted payout grids. Are you familiar with those, under which a broker can receive exponential gross dealer concessions?

For example, a $200 payout for one recommendation versus a $30,000 payout for another. Do you think those incentives matter and are likely to affect the broker's ultimate decision and recommendation?

MR. COLLINS: So, look, I'm an economist. I think incentives matter. I think the question at hand, though, is do those incentives show up systemically at a macroeconomic level, at such an important level that we should pass a rule that burdens the industry and potentially, investors with billions of dollars of lost returns, and billions of dollars in extra costs?

So, what we've tried to do is take a pretty simple approach to that, which is say, let's look at what we can see in the data.

(Break in recording)

MR. BAILY: -- you want to --

MS. DOKKO: I agree with Sean. I'm an economist, as well, and I believe that incentives matter, and they matter a lot for behavior. And they matter, you know, in this country. They matter in other countries. They matter in a variety of different institutional contexts. They matter for, you know, lots of different people at all different levels.

And I think, you know, it just sort of speaks to the importance of why we're here. And I disagree with Sean on the interpretation of the macro evidence. I believe that -- you know, something entirely different about sort of the systemic nature of the costs.

MR. BAILY: Okay. Another question? Yes?

(Break in recording)

(Simultaneous discussion)

MR. BAILY: Would you identify yourself?

SPEAKER: Yes. My name is a Doma and I'm a Tibetan freelance journalist. I did work on the business features or the story for quite a bit. I did a lot of research. So, as a very good, honest, exemplary citizen, that's how I think of myself, and I would like to protect at least people like myself, you know, who try to be so obedient and so good and so civilized.

MR. BAILY: Okay, let's get to a question.

SPEAKER: Right.

MR. BAILY: Yes?

SPEAKER: And then, you see all of these nasty practices, and nobody is speaking about anything. And I'm from a small village in India, and I'm quite ashamed to say this, but are you guys at the lowest level now, since many people talked with specific related topics? But I'm addressing on the lowest level, or as the fundamental like kindergarten level --

MR. BAILY: Give us question.

SPEAKER: -- whether you guys are well informed about the big changes? Since the last five, six years, it's been going on really, really, almost like robbing inside a bank. I have a bank (Inaudible) --

(Simultaneous discussion)

MR. BAILY: Okay, that's enough. Thank you very much for your --

SPEAKER: Yeah, so the --

MR. BAILY: -- for your question.

SPEAKER: Yeah, hard earned saved --

(Discussion off the record)

(Break in recording)

MR. BAILY: We can't cover -- we've had a lot of events here at Brookings on the financial crisis. We've had a range of different views about the financial question. But I don't think your question was really geared for this particular panel. If either of the panelists want to comment, you're very welcome to. But I don't think it's really relevant to this discussion.

(Break in recording)

MR. BAILY: Yes?

MR. BANKS: Hello. Hi. My name is Christopher Banks. I'm here with the Department of Labor. I had a question geared to Sean. In your cost benefit analysis, you targeted investors who had less than $100,000, and said that because of the money that they would no longer be able to invest, it would cost the economy or investors around 60 billion.

But in your analysis, did you take into affect auto performing plans, such as what betterment is doing as far as running algorithms for small time investors? And if so, would that not decrease or mitigate that loss that you had?

MR. COLLINS: Okay. So, I guess the question is --

(Break in recording)

MR. COLLINS: -- automatic advice -- you know, automated advice. How do I feel about it? I think you know, automated advice is a way of the future. A lot of our members offer it. And you know, it can be very appropriate for the right person and the right circumstances.

I think the question is, are you going to try and force people into automated advice, because you think that they're getting something different than what you want at a broker. So, for example, you know, certain people may want the personal

touch. They may want to be able to call up somebody and say, at the other end of the phone, get a human being.

I mean, personally, I find nothing more frustrating than when I pick up the phone and I call the bank, and I have to sit there and hit zero about 10 times before I can get a human being. Sometimes, you just want a human being. Automated advice providers often provide that, but at an additional cost.

Also, there are other things that -- you know, some people may not realize fully about automated advice providers. For example, some of the automated advice providers make you sign a contract that say you will agree to any trades that we make. So, in some sense, you lose the ability to control your portfolio under some circumstances. They do that for a good reason, which is they are low cost providers. If you're going to give people customized service, that's going to be more expensive. And so, the way they keep costs down partly is by enforcing the same kinds of trades on everybody in the plan.

MR. BAILY: What's your view of automated advice? I think it was proposed -- the CEA report sort of suggested that it was a good way to go.

MS. DOKKO: Yeah, I think --

MR. BAILY: I mean, you don't have to agree with that.

MS. DOKKO: I don't have to agree with that report (Laughter). No, that's right.

MR. BAILY: Their report.

MS. DOKKO: That's right. No, I think you know, there are a lot of new and interesting and exciting and emerging trends with technology. And you know, as an economist, one thing that I would you know, really hate to see is for innovation to be damped in this sector because of sort of either you know, regulatory rigidities or you know, various -- the way that certain sectors, you know, capture rents, and unfairly sort of tilt the playing field. I think that -- I mean, from a personal perspective, robots are sort of attractive, because they don't have like human emotion (Laughter).

MR. BAILY: How do you know if you've got the right robot?

MS. DOKKO: How do I know if I have the right robot (Laughter)?

MR. BAILY: And this is not a scam operating out of some (Laughter) strange, obscure part of the country.

MS. DOKKO: I think that's right. And you know, I think as the industry sort of -- as sort of the model generated, you know, advice industry develops, you know, hopefully, the incentives and the market structure will be such that you know, reputation matters. And you know, some firms will be able to you know, rise above you know, others to do that.

And hopefully, the right regulations will be in place in order to prevent you know, sort of gross consumer abuses from the random robot, you know, in American Samoa (Laughter) who is going to call.

MR. BAILY: I wasn't going to name any country, but --

(Simultaneous discussion)

MR. COLLINS: Could I just --

MR. BAILY: Yeah.

MR. COLLINS: -- redirect for just a second?

MR. BAILY: Sure.

MR. COLLINS: Just so I don't leave any missing prejudice. Look, I think automated advice is a way of the future, and it's a great innovation. I think what we would prefer to see is competition in the market, and let the best man win. On the question of --

MR. BAILY: Or woman. Yes.

MS. DOKKO: Or woman.

MR. COLLINS: Sorry (Laughter). I will pay a deadly price for that later (Laughter). On the question of, you know, could there be a bad automated advice provider out there, you know, look, these guys are registered under the Investment Advisor's Act. So, they're held to a very high standard, as well.

So I mean, you know, in any kind of business, there can be you know, bad apples. But I think generally, the very well known automated advice providers are -- I think everybody thinks they're very high quality.

MR. BAILY: On that note of agreement, I think we're going to call it a day. We have our next panel coming up at 3:30, and it is Friday afternoon. So, I want to give enough time for the next panel. Thank you very much. (Applause)

(Recess)

MR. GOTBAUM: Good afternoon. Maybe my starting to talk will scare people to come back in, or maybe it will convince them to stay outside and continue their coffee. I'm Josh Gotbaum; I'm a Guest Scholar in Economic Studies at the Brookings Institution.

One of the proverbs -- and I'm conflicted since this is talking about the conflict of interest rules -- I am multiply conflicted. As I mentioned earlier I ran an organization whose board chair was the Secretary of Labor. I also spent most of my life in the financial services industry. So all sides could consider me a traitor. (Laughter) One of the proverbs that people in government pass on is that if a government action makes everyone unhappy, and they all want changes in different directions, then government is probably doing it about right. But, there is another possibility. It could be the government is doing something that it hasn't done before, that it's doing it for the first time, and that government too knows that it needs and wants to make changes as it goes along. That's what's happening here.

In 2010 the Department of Labor proposed to expand the scope of fiduciary requirements. That proposal was widely criticized. The Department announced that it would revise them shortly, and then went silent for four years. This time the Department has made a point of consulting publicly and widely and asking for suggestions. And as Secretary Perez pointed out, it has received thousands of them. Of course that doesn't mean that they will or should take all of them, most of them, whatever. These proposals are controversial. There is no way they could not be. What

the Department is proposing is to extend a standard of conduct and the regulatory architecture of fiduciary duty to people and organizations that have not been under them before, who are under different regulatory regimes and different legal standards. It is not a surprise therefore that the industry is nervous. Will the Department of Labor understand their business, will the Department of Labor work with their businesses, or will the Department of Labor put them out of business. Will products that require sales, that require an effort just to explain them, lose out if they can't pay a commission. So there is lots of interest, lots of nervousness, and as the Secretary mentioned, 300,000+ suggestions.

We've assembled this afternoon to talk about this a group of folks with expertise and interest in DOL's rule making. They have widely differently experience and views. Two are strong supporters of DOL's proposal, two would like to change it very substantially or for DOL not to act at all. We have asked them for this panel not just to give a thumbs up or thumbs down on the rule as proposed, but from their perspective, from the interest that they speak to, what should be done to improve it. We do this for two reasons. One because it is very clear that the Department of Labor is going to act, they are going to do something to help people get unconflicted retirement advice. They are not going to wait for further deliberation by the Securities and Exchange Commission. Second, because -- and I speak here as a person who has worked with lots of government agencies -- by comparison with some unnamed government agencies, the Department has actually been more open about the fact that this effort is a work in progress, and that it will be improved over time.

We'll first hear this afternoon from Kent Mason, an attorney who lobbies on behalf of both the sponsors of retirement plans and financial services business. Then we'll hear from Barbara Roper, Director of Investor Protection for the Consumer Federation of America. Then we'll hear from Jim Szostek, who is responsible for tax and retirement policy at the American Council of Life Insurers. And last, but definitely not least, we'll hear from Marilyn Mohrman-Gillis, who directs public policy for the Board of

Certified Financial Planners. And the reason we asked Marilyn is because CFPs have worked under similar standards, not the exact same standards, as those being proposed by DOL for some number of years. After Marilyn's comments we'll all come up, I'll ask some questions, try to get a discussion going, and then we'll take questions from the panel.

And so, without further ado, Kent Mason. (Applause)

MR. MASON: Hi, and thanks, Josh. I guess I'm going to disagree with you on one point, just to start us off here. What a great and fun way to spend a Friday afternoon. (Laughter) I mean, come on, guys, really. All right. So to sort of fulfill what Josh says, to say sort of where should we go from here, I think the best thing to do, and unfortunately this takes a little bit of warm up here, which is what is the DOL proposing? What's current law, what are the proposing, and what are the problems? You know, what is it that the industry has concerns about? So I think there's a little groundwork and hopefully this will be helpful to everybody in terms of sort of just setting a stage, and I'll try and be really brief on the geeky stuff.

Under current law the financial professional becomes an ERISA fiduciary. They provide individualized investment advice for a fee on a regular basis pursuant to a mutual understanding that that advice will serve as a primary basis for decision making. So I want to sort of emphasize a couple of points. A regular basis, and it needs to serve as a primary basis for decision making. And I think the DOL at the outset said, look, we have some concerns about this definition. And I think they are fair concerns. Why does it have to be a regular basis? What if you give an important piece of advice and it's only one time, shouldn't that be fiduciary advice and shouldn't that be in the best interest of the client? That's a fair concern. What if on this primary concept, what if you have two or three advisors and you rely on the group and no one is primary? Aren't you really relying on them, but you're not relying on anybody in a primary sense. Yeah, that's a fair point. So I think there is broad consensus that the current definition is too narrow and it needs to be broadened.

On the other hand -- and I'm going to be very brief on this because I don't want to spend that much time on this point -- I think the DOL went to the other extreme. And just to illustrate, essentially what they said was you're a fiduciary if you provide an individualized suggestion -- and they use the word recommendation, but they define it to mean suggestion -- so an individualized suggestion for consideration. A suggestion for consideration. That's a little bit too low a bar. I mean any casual conversation could be an individualized suggestion for consideration. But I just want to sort of put that sort of current law proposal, and I want to put that aside because I really do want to focus on sort of what Josh's objective is here, and I think everybody's objective is, where is the middle ground. And I think that the middle ground is we can work out this issue of where the sort of the breadth of, the expansion of this definition.

But that's really not the core problem because there has been widespread agreement for five years that financial professionals should -- when they give advice it should be in the best interest of their clients. The industry hasn't -- I sent in something in 2011 saying fine, to the DOL, absolutely fine. That's not been the debate. The debate has not had anything to do with the best interest standard. The debate has been with other aspects of the DOL rule that haven't been mentioned here today that would preclude access to small accounts and small businesses from getting investment information. Well, what are those rules? They're called the prohibited transaction rules. What are the prohibited transaction rules? They say if you're a fiduciary you can't give any advice if that advice could result in you getting more compensation. So I'm just going to use a very simple example. Josh comes to me and he says I've got a little extra cash in my IRA, what about this XYZ stock, do you think that's a good idea. And I say well, gee, our research folks think it's a good buy and it fits your portfolio, you know, it seems like a good purchase for you. And suppose that was the perfect advice? I just committed a prohibited transaction. Because if Josh stays put I earn nothing, and if Josh buys that stock I get a $20 commission. I just committed a prohibited transaction. So unless we have an exemption from those prohibited transaction rules in the retirement space, the

brokerage model is illegal because the brokerage model always involves commissions, mutual fund payments. So your pay will always be affected by the advice you give.

So in that context I guess I'm going to ask two questions and I'm going to ask them in a little bit the reverse order than you may want to think. The first question I'm going to ask, what if the brokerage model is illegal, who does that affect? It affects the small accounts, and here's why: because they are two ways to get investment advice. And I'm going to use Josh again because I'm just going to pick on him relentlessly here because I disagreed with him so strongly about not being fun on a Friday afternoon. (Laughter) So what I'm doing here is Josh comes to me and he says, I've got $500,000 in my IRA, I want you to just manage it. Well, I have something called an advisory service and I will take on 365 days of liability for John to manage his portfolio for a flat fee like one 1 percent of assets. So he gives me $500,000 to manage, he pays me $5,000 a year, everything is good. It's a flat fee, there's no violation of prohibited transaction rules. But them my fellow panelist Jim Szostek, he's not doing nearly as well as Josh. He comes to me with a $4,000 IRA and says I want to open an advisory account. And I say, look, Jim, I can't do that. I'm not taking 365 days of liability for 1 percent of $4,000; I'm not taking it for $40. And so almost all the major financial institutions have a minimum on their advisory accounts, $50,000, $100,000 or higher. So the wealthy are fine under this rule. If the broker's model is illegal -- I mean they may pay a little more but they can still get advice. But the small guy, the brokerage model is illegal and the advisory services, they're not big enough. So they're the ones who lose out. So then the key question is, is there an exemption from these prohibited transaction rules? And the answer in classic Washington case is yes and no. And there is on technically, it's called the best interest contract exemption, best interest contract exemption. And depending on what kind of person you are, you can call it BIC or the BICE. And if you have a lot of European flair, the BICE. (Laughter) I have no flair; I'm going to call it the BIC. And so during Q & A maybe we can talk a little bit more about the details because I don't have the time in my little spiel here to give you details, but the short answer is in the last several months I've

talked to dozens and dozens of financial institutions, and I have found one that's considering using the BIC -- one. And I said to them, really, that's interesting. Could you use it in eight months because that's the time to have from the DOL to get this in place? And they said of course not, this is a three year project. We can build it we think -- we think we can build it, but this is easily three years. I've heard of other people considering using it, I've asked about them, sort of the third parties, and they I well could they use it within eight months? They said of course not, it's a three year project. You know, two, three, four year project.

So at the end of eight months, no one will use the BIC. So what's going to happen? Now I guess before I sort of get to sort of what's going to happen, I think some people say to me, wait a second, I was here when the Secretary spoke, he said we're taking into account all these comments. They're going to make this work. Well, I sat through four days of hearings, I had my meeting with the DOL, I've had reports from -- almost dozens of different groups have gone in to meet with the DOL -- and this is my view, but it's the view I feel very strongly about, all of the changes being contemplated are just around the edges. Nothing would change the fundamental structure of the BIC, nothing would change the conclusion I just articulated, that people can't and won't use the BIC, which means the brokerage model is illegal, which means small accounts get cut off from information.

So what is happening right now? The financial institutions I'm talking to are making active plans -- this isn't hypothetical, they are making active plans to fire well over 20 million small IRAs in the summer and fall of 2016. Well, over. And this isn't hypothetical. I've talked to somebody and I said well what about this and what about that, and they said oh, yeah, we've got that all planned out as to how we're going to do that. They are making plans to do that because they see the handwriting on the wall. What else is going to happen? You'll see small businesses unable to get help setting up a plan because in order to set up a plan you need to choose investment options to offer your employees. You can't do that, that would be a prohibited transaction for a financial

institution to help, and the BIC doesn't even apply there. And again this is an issue we can go into more detail. And I was with a group of large businesses the other day, they said to me in light of the investment education changes they would all shut down their investment education programs. So why is this going to happen? I think sort of the Secretary sort of alluded to, and I think other people alluded to, there's $17 billion out there, the industry is not going to walk away from $17 billion. Of course they're going to adapt and do the BIC. And this is the whole point. And the point is if you looked at Sean's chart, do you know how much of the assets is over $25,000 -- 96 percent of the assets. So if you fire all the small accounts you lose nothing because everyone loses money on the small accounts. You cannot profitably serve the small accounts. You cannot profitably serve them. They're an investment in the future. And this is evidenced by what's happened in the UK. And I'm going to explain this in a second, but the UK has established a rule with the exact same effect. And the industry over there said we'll walk away from small accounts. Regulators said oh no, you won't. Industry did in 2013 they walked away in droves. And since then DOL and the UK have said oh, everything is wonderful in the UK. And sometimes they say no one has walked away, and then sometimes they well, they walked away for other reasons. But the bottom line is they say everything is wonderful. And even today we heard it; everything is wonderful in the UK. Except the UK now disagrees with that. In the beginning of August UK announced things are terrible; there's a major review of the advice gap that small accounts cannot get help over there in the UK. And why is this the exact same effect? Because as Josh pointed out, the UK banned payments from the mutual funds to the advisors and technically you can have payment under the DOL rule from mutual funds to advisors, but to do that you have to use the BIC and nobody can use the BIC. So the exact same effect.

I'm going to close with three recommendations. How can we sort of fix this problem? It's really simple, and this issue for years has cried out for a wonderful middle ground. We're fine with the best interest standard; why not have a broad best interest stand that requires financial professionals to act in the best interest of their

customer? And then instead of this 18 part BIC that nobody can use, why not a very simple BIC that has 2 requirements. One, you act in the best interest of your client, and two, you have full, fair, clear, simple disclosure of your financial interest. Third component is there needs to be an appropriate transition period here. The DOL proposed eight months. You cannot restructure an entire business in eight months, you cannot do that. It's not like it's maybe, it's not like oh yeah, we can try, you can't do that. Why did they propose it? I read through 260 pages of economic analysis, there's not a single piece of policy or economic analysis in their entire multi-hundred page document as to why 8 months. They never looked at it. So do you want me to tell you why? Because eight months is when they leave office. And that's a sad, sad way to make a rule. You need to allow a real transition, not based on sort of political sort of pressures.

So I think there's a great opportunity to do something good. Right now we're heading for a crash and it's too bad because there is such a great opportunity in the middle to do something good. And I'm finally wrapping up on a Friday afternoon. (Laughter)

MS. ROPER: Hi, I'm Barb Roper with Consumer Federation of America. It's really tempting to get into a debate and just sort of explain why I disagree with almost everything that was just said, except that we need a reasonable transition period. But I'm not going to do that today. I'm going to follow my instructions and I'm going to have a positive message about why we think this is the right approach to improve our regulation of retirement savings.

So we have chosen as a matter of policy in this country to create a retirement system in which American workers and retirees are largely responsible for making the decisions that will determine their ability to afford an independent and secure retirement. And we have done that despite the fact that many if not most Americans lack basic financial literacy skills, let alone the financial sophistication to make those more complex investment decisions. In essence, we are all but forcing them to turn to financial professionals for assistance, and the least we can do under the circumstances is ensure

that the financial professionals they turn to for advice have a legal obligation, an enforceable obligation to act in the best interest of their customers. Unfortunately, neither our securities laws or our insurance law nor the rules under ERISA currently provide that insurance. And instead we actually deprive investors of fiduciary protections when the conflicts of interest are most intense and thus the risks to the investor are greatest.

So we believe that the first thing that we need to do to solve this problem is to close the loopholes in the existing definition of investment advice -- so I guess that's sort of two things we at least kind of agree on -- so that in the future firms will not be able to evade their fiduciary responsibilities by disclaiming them away or because it's one time recommendation or it's a rollover recommendation that currently are covered in the definition. And that's exactly what the DOL rule proposal does, and we think does very effectively. And a very important improvement in the current proposal over the 2010 proposal is it does affirmatively include rollover recommendations, which is essential since these are for many people the most important financial decision they will ever make and a point of ultimate vulnerability for retirement savers.

So while we strongly support this decision to cast a wide net when defining the fiduciary investment advice, it does indeed raise this question of what are you doing to do about the many financial professionals who now fit the definition, but are compensated in ways that are not permitted under ERISA because ERISA does impose a solely in the interest standard, and it prohibits compensation as Kent said, that it varies based on the product the investment recommended. And you could do what the United Kingdom has done, and say you're simply going to enforce the solely incidental standard. But even if you think that is an attractive alternative, and there are people who do, it is not in our view a politically feasible approach in this environment, which is perhaps Kent and his clients keep suggesting that that is what the DOL has done when in fact it is clearly not. What DOL has done instead is look to the securities laws for a model, and they found that model in Section 913 of the Dodd-Frank Act. So they said financial professionals, brokers, insurance agents, can get their conflicted compensation, they can

get their commissions and their 12b-1 fees, and their revenue sharing payments, et cetera, but when they do so the advisors have to agree to set aside their own financial interests when determining what's best for the customer and then make recommendations that are indeed in the best interest of the customer designed to serve the best interest of the customer. And we support this approach, CFA supports this approach as a reasonable compromise, albeit one that carries risks because the best interest standard is a pretty nebulous concept to rely on in the face of the complex web of toxic incentives that have been built into the broker-dealer and insurance compensation systems.

So the essential question for us then is what are we going to do to make this best interest standard reasonable, meaningful. You know, what are we going to do to make sure that it actually brings about the change in conduct that we think is necessary to improve protections for retirement savers. And we believe there are sort of two essential elements for a best interest standard with teeth. The first is it has to be enforceable. And that in our view is the brilliance of the contract requirement, in the best interest contract exemption, which is it creates an enforcement mechanism for the best interest standard that is not entirely dependent on reluctant and underfunded regulators. And second, we have to recognize that if we want financial advisors to act in the best interest of their customers we have to stop paying them and incenting them in ways that encourage them to act against the best interest of their customers. And here again we believe the DOL rule gets it right because it backs up its best interest standard with real restraints on the kind of common industry practices that encourage advice that is not in the customer's best interest. SO just to be clear here, we are not talking about eliminating advisors' ability to be paid through commissions or 12b-1s, et cetera, but we are talking about eliminating practices like setting sales quotas for the sale of certain products, like say proprietary products, and then basing bonuses and payout ratios based on the salesman's success in meeting those quotas. And we are talking about eliminating compensation systems that pay advisors more, and in some cases much,

much more to recommend one product over another based on no difference in the amount of time or expertise or work involved in making that recommendation. And in particular we should not tolerate compensation practices that pay advisors more to recommend products that carry higher risks or that are less liquid and thus create an incentive for advisors to move retirement savers into investments that expose them to unnecessary risks and excess costs.

And much as I appreciate the industry's recent conversion to support for a best interest standard, I say put your money where your mouth is. Because no firm that really wants its advisors to act in their customers' best interest would pay them this way. And there are in fact firms that have taken affirmative steps, much to their credit, to eliminate, to mitigate these kinds of conflicts that exacerbate the sales-based conflict of interest, which suggests to me that this provision of the rule is not unworkable as some have suggested, but simply unpalatable to firms that have found the status quo to be extremely profitable.

So these for us are the core provisions that the regulations must include. The fiduciary standard has to broadly apply to the full range of services that are perceived and relied on by investors as objective advice. It has to be enforceable and it has to be backed by real restraints on the incentives that financial advisors have to act in ways that are not in their customers' best interest. And I might add, those key elements, those core principals, are missing from every single industry alternative that has been put forward, whether it's from CIPMA or FSI or FSR 29:38 or Fidelity. They are missing these three essential components, and instead they suggest for example that we should deal with conflicts through disclosures which are known to be ineffective.

So finally, I would close by saying that the DOL can and will make adjustments to the rule, that is after all what the comment process is for. And we would expect, for example, to see changes designed to make the contract easier to get into place, to clarify that firms are free to market their services without triggering the fiduciary obligation, to simplify the disclosures, to deal with the asset allocation tools, to make sure

that small participant-directed plans can rely on the BIC, and as I said, we would expect to see a longer implementation period. Eight months isn't reasonable, three years is excessive. We think there is a compromise in the middle. But what DOL should not do, and what I'm actually fairly confident that they will not do, is compromise on these core principles. And while that will not solve every problem with our current retirement system, it will bring us one giant step closer to giving retirement savers advice that they can trust.

Thank you. (Applause)

MR. SZOSTEK: Good afternoon. My name is Jim Szostek; I'm with the American Council of Life Insurers, although these are my comments and not theirs per se. I'd like to talk to you today about guaranteed lifetime income and what needs to change in the DOL's proposal to ensure that workers have access to and information about annuities.

Seventy-five million Americans rely on ACLI member products for financial and retirement security, products such as life insurance, annuities, long-term care and disability insurance -- you're familiar with these. Workers obtain these products at workplace and on an individual basis through insurance agents and other financial professionals. But I want to focus on annuities. Seniors need the income protections that annuities provide. Annuities are the sole means available on the marketplace today to secure income for life. In the absence of an annuity, you do not have a guaranteed income for life. Before I get to the DOL's fiduciary proposal I would like to note the good work that the Obama administration has done to bring annuities into focus.

In 2010 the DOL, Treasury, and IRS gathered important information about the ways agencies could facilities access to and use of annuities. Treasury and IRS have cleared the way for the use of longevity annuities, these deeply deferred annuities that start payments for example at age 85 in qualified plans in IRAs. The agencies have also clarified how annuities can be embedded within 401K plan investment features. That was very helpful guidance. Again the administration has done much. They were also talking about exploring ways in which 401K benefit statements

could illustrate the value of your account, if you will, your 401K account as like monthly lifetime income, something the thrift savings plan already does today for its members.

As for the fiduciary proposal, let me be clear, ACLI supports sound regulation that promotes good business practices that serve the best interest of savers and retirees. The DOL's proposal needs a lot of work to get there. The rule needs to be fixed so that insurers can continue to encourage small businesses to establish plans, encourage savings and discourage retirement plan leakage, engage savers and retirees about the benefits of using a portion of their savings to secure retirement income with an annuity. The Department's regulation should promote the alignment of interests between insurers, participants, plan sponsors, workers, retirees. Everyone benefits when there are more workplace savings plan, when the savings rates are improved, and service providers intervene to discourage cash outs, and when there is access to and information about annuities.

The proposal needs material changes. We submitted 342 pages of comments to the Department of Labor. Let me share with you a few ways, not all the ways that we've commented on, but a few of the ways (laughter) -- I know Josh would appreciate that -- a few of the ways that we suggested that the proposal get fixed. In order to purchase an annuity workers first need to save. The proposal as drafted will frustrate the formation of savings plans for workers employed by small businesses. It's done in -- a number of ways why this is true. Under the proposal life insurers and financial professionals will no longer be permitted to encourage small business owners to establish workplace savings plans, something that's done today. It's what we do. If you are familiar with the insurance industry, many small plans are funded with insurance products. The proposal denies small business owners access to product sales, and it denies advice fiduciaries access to the best interest contract exemption for the sale of products to 401K plans.

Under the proposal small business owners must take the initiatives to encourage themselves to establish a savings plan for the workers. They must expend

their own resources to hire a third-part fiduciary to assist them. This is unrealistic. Today's small business retirement plan coverage is a challenge. Absent material changes this proposal was a direct threat to the financial wellbeing of so many workers, many of whom earn low to moderate wages. Savers and retirees and insurers and other financial professionals need rules that foster a robust marketplace with a variety of choices and competitive prices. The proposal seller exemption for large plans relies on fair and transparent disclosure. So there is a seller's exemption. I'm a sales person, I'm selling, this is a sales pitch. You're going to be sold something. I'm selling you an annuity right now. That works for large plans, but for some reason when you get to 99 participants you're a small plan and you no longer have that exemption available to you. It should be extended to any and everyone. The first proposal included a seller's exemption; this one has an extremely limited one. If Congress intended for ordinary sales suggestions to be subject to a sole interest fiduciary standard, it would have written different language into the statute. The language in the statute is about investment advice for a fee. It would have been very easy for Congress back in 1974 to subject to anyone selling anything to anybody to be a fiduciary.

ACLI members are gravely concerned that as currently drafted the proposal will drive financial firms to move to levelized compensation arrangements in a way that will no longer appropriately compensate them for the sale of annuity and other insurance products. The best interest contract exemption increases legal exposure while failing to provide certainty that businesses need to transact. For example, under the best interest contract exemption how will an insurer or its agent know when compensation is reasonable? When courts decide? How can anyone engaged in commerce act without regard to their own interest? It's the language in the exemption. While it's called a best interest standard -- we've heard a lot, that best interest, and we support beset interest -- it remains the sole interest standard. Sole interest works for those in the business of providing only advice. But how can it work for those engaged in sales activities, sole interest? A true best interest standard would permit the subordination of other interests,

but not preclude other interests.

As for compensation, the exemption is available only to fiduciary advisors that receive reasonable compensation for total services provided. Today compensation is set in a competitive marketplace. Given the work involved to educate consumers during the annuity sales process it's no surprise that annuity compensation differs from that of other compensation paid for the sale of investments without life and income guarantees. I've heard a lot about compensation today, and clearly if annuity sales compensation was pushing people in a particular direction everyone would have one. So for those compensated on a commission basis, or a percentage of assets under management for example, how do you know your compensation is reasonable? At the very least the Department should allow for reasonable and customary compensation. That would give the Department a path to address compensation practices that are not reasonable based on the facts and circumstances, outliers if you will. Of course you could move to a level of compensation arrangement such as an hourly fee arrangement. If you did, you would not need an exemption. So you don't even have to look at the best interest contract exemption -- I charge X number of dollars per hour. Level compensation would remove the subsidization that occurs today between large and small account balance investors. I'm going to repeat, level compensation would remove the subsidization that occurs today between large and small account balance investors. Would moderate balance investors take the initiative and pay for multiple discussions with an advisor to evaluate the costs benefits and the features in an annuity and just write a check? Maybe I've got some more questions, I'll write another check.

Let me close by pointing out the fact that ACLI and its members stand ready to work with the Department of Labor to engage that its regulation protects retirement savers while continuing to provide them with essential products and service. Absent significant changes, this proposal will do much harm. Some have suggested that those that find any fault with this proposal want to reopen loopholes, water it down, to encourage advice that is not in retirement savers' best interest. ACLI has offered

substantive feedback to ensure that the Department adopts a workable, clear, and unambiguous rule, one that promotes good business practices that serve the best interest of savers and retirees in a robust and competitive marketplace. (Applause)

MS. MOHRMAN-GILLIS: Good afternoon and again I'm Marilyn Mohrman-Gillis, and I'm with the Certified Planner Board of Standards. And actually my introductory remarks are on behalf of the Financial Planning Coalition, which includes the Financial Planning Association and the National Association of Personal Financial Advisors. So what unites us in the coalition, we were formed about six years ago around the principle that advice should be delivered at a fiduciary standard of care. And so we believe that a strength and fiduciary standard under the DOL rule is much needed and long overdue and strongly supported.

But I am here at Josh's invitation really to talk about the unique perspective that we bring to the table. Our stakeholders have committed to operate under fiduciary standard of care by virtue of their CFP certification, or by virtue of their code of conduct that they agreed to abide by as a member of FPA and NAPFA. And we provide fiduciary level of services across business models. So CFP professionals are investment advisors, they're broker-dealers, they're insurance producers, many have dual licenses, or licenses in all three categories, and provide services under varied compensation models. So they provide services as commission only, commission and fee, fee only, or combinations thereof. So based upon our experience, we think that there really is a lot of misinformation about this rule that is out there and many of the arguments that are being made against the rule we believe are just simply not true. They're not consistent with the rule, they're not consistent with research, at least that we have done and are aware of, and they're not consistent with our experience.

When CFP Board put in place a fiduciary standard of care, this was in 2007. At that time we heard the exact same arguments that many opponents are making against the rule, and in fact that you heard from this podium today, that this is not workable, that the CFP professionals in these various firms could never operate under a

fiduciary standard of care, and that the CFP professionals, if they had to work under a fiduciary standard of care would be required to rescind their certification. So I'm here to tell you that contrary to all of these predictions that the sky would fall, the sky did not fall, and in fact, since 2007 the number of CFP professionals has grown by over 30 percent and is now at almost 73,000 nationwide.

So let's look at some of those sort of concerns that have been articulated. I know Kent repeatedly told you that the broker-dealer model is illegal. Well, the argument that the DOL rule will eliminate the broker-dealer model and essentially will force advisors into fee only business models is belied -- is just not consistent with our experience, and quite frankly it's not consistent with the rule as it's written. Advisors do not have to give up commissions. They can still provide advice under the rule and receive commissions. How? Under the best interest contract exemption, which is a principle based business model neutral exemption to the sole interest standard. Advisors can continue to receive commissions under a fiduciary standard under ERISA. In fact, as Barb indicated, in many ways this is really an important accommodation that the Department of Labor has made to the sole interest standard. It is a best interest contract exemption. And quite frankly, when I first read it I thought that it was an interesting road map for a fiduciary standard under this SEC Section 913 Dodd-Frank best interest standard.

. And to those who say that this BIC contract is unworkable, we point to our own standards. The CFP Board has standards of professional conduct, they've been in place, and they are standards that are developed through a very careful process by CFP professionals and others and reviewed by CFP professionals. Those standards, those requirements that are currently in place in our standards are very similar in many ways to the BIC exemption. So what do our folks have to do? They have to act in the best interest of the client, they have to exercise reasonable and prudent judgment, they have to execute a written contract when they're providing financial planning services, they have to identify and mitigate conflicts of interest, and they have to provide written

disclosures that include the full cost of the products and services that they are recommending, and the compensation that is being paid to them and the compensation that is being paid to their employer. So in many respects, if you look at the requirements of the BIC exemption they are very similar to the requirements that our CFP professionals are operating under today. And they're operating under these requirements not just with a fee only business model, but with combinations of commission and fee, and commission business models.

Another interesting argument is that if I'm required to provide financial advice under a best interest contract exemption, which basically says I'll work in your best interest and I'll obligate myself to work in your best interest, that I won't be able to serve small savers. Again, our experience and our research really just belie that argument. There are thousands of CFP professionals and FPA members and NAPFA members across the country today who are providing fiduciary level services to everyday Americans, small savers and large savers, under commission based business models, as well as fee for either very low minimum asset center management or no minimum asset center management. If our experience is any indication of what's likely to happen, you know the financial services industry is very flexible. They have adapted over the years with new business models, with ways to adapt to the changing environment, and we see evidence of it in today's marketplace already that it's more likely that they will adjust their policies and procedures rather than abandon the middle class clients or small savers.

The re-proposed rule we think is a substantial improvement over the 2010 rule. The DOL -- and you heard from the Secretary today -- is bending over backwards to listen to and to take into consideration comments. In our comment letter we had 15 pages of recommendations to the DOL for how it could adjust the rule to make sure that it is operational across business models. And we believe based upon the statements that both the Secretary and other DOL officials have made publicly, that they are seriously considering a significant number of adjustments to the rule. Barb mentioned most of those. The bottom line is that the DOL is the expert agency to

implement Congress' original intent in 1974 that advice to tax preferred retirement savings needs to be at a fiduciary level of care and the DOL is updating a 40 year old rule to make sure that that happens.

We think -- and I think Barb touched on this a little bit -- that American retirement savers today face a perfect storm in that they are now responsible for their retirements at a time when the products and services are so complex. There is a huge differential gap in knowledge. When there's a differential gap in knowledge between the consumer and the advisor that is the time when it is absolutely imperative that that advice be delivered at a fiduciary standard of care.

Thank you very much. (Applause)

MR. GOTBAUM: For all those of you who like Kent think this is a great way to spend the afternoon, thank you very must for staying there and convincing those of you who do not, that's worth sticking around.

Let me start by asking all of you about Great Britain because what I've observed here is that the UK -- is that actions by the UK government, a conservative government, they consider these issues and they did -- I can't even remember the exact name of the review.

SPEAKER: RDR.

SPEAKER: I just call it RDR.

MR. GOTBAUM: Yes, the Retail Distribution Review. See, I did read my talking points. They did a Retail Distribution Review, and they concluded from this that the right way to do this was to abolish product based commissions entirely. They then, in a way that I wish again some parts of the U.S. government would due, gathered evidence to evaluate what they did and issued the Post Implementation Review. And now a separate part of the UK government is doing another review, the nature of which is to me not entirely clear. But since the UK example is being cited both by people who think the Department of Labor has not gone far enough, and by folks who think the Department of Labor has gone too far, I'd be interested in having each of you talk about what lessons

you take away from the UK experience.

MR. SZOSTEK: Pick the order, Josh.

MR. GOTBAUM: I'm agnostic.

MR. SZOSTEK: Well, what we understand happened in the UK, you described it. I think it's important for people to realize that the UK prior to the RDR had a different regulatory regime in place to protect consumers than we have here in the U.S. So they didn't necessarily have a (inaudible) on the SEC. We have a lot of the rules and regulations we have in place today to protect consumers. So the reaction, this banning of commissions can tend to be maybe a blunt instrument that would solve a problem that they perceived needed to be solved. You know, I've got an anecdote. Besides, you know, the review that's underway now and some of the reports from Cass Business, you know, my little Apple device as a Sky News icon and you can click on it and watch some of the UK press releases and some of the reporting done in the UK. I was struck by earlier this year of a report -- and you may be aware of this as well, but the UK has changed its mandatory annuity policy, party driven I think by revenue demands. And they were interviewing a middle class retiree that was frustrated by the fact that no one would talk to him. I can't get any information. I don't know about the annuity, I don't know about cash that I can take, I don't know where to invest, I can't seem to get through to anybody. And that frustration was real and it was a real report. I mean, so people are being impacted by this decision and I think that's what you're seeing in the reaction in the UK is we've got to do something, something is not right here.

MR. GOTBAUM: So you think the quality of regulatory oversight was different, the quality of services was different? Other reactions?

MS. ROPER: Sure. So I mean I think there have been several fairly comprehensive studies done, put out, reviewing what happened in the UK. There was, after the RDR was adopted, a drop in the number of advisors which the studies say have little if anything to do with the commission ban and are related to the fact that at the same time they imposed a new professional credential requirement, increased some regulatory

fees. There is according to these studies not an advice gap that's resulted despite this drop in numbers. According to the latest study there is in fact excess capacity of roughly 5,000 advisors in the UK. More importantly, I think the research indicates the quality of advice has gone up. It is more professional, it is less biased by investment considerations. There is not clear indication yet on what's happened to the cost of advice. There is a clear indication that the cost of investment products has come down. Not surprisingly -- and this is something we would hope to see with the DOL rule -- when you free financial advisors from the tyranny of owing their compensation to product sponsors, they bring competitive forces to bear in that investment market. Right now you have investment products in the United States that compete to be sold rather than competing to be bought. And they compete to be sold in ways that drive up the costs to investors and work against their interest. One of the hopes that we have for the DOL rule is that it will bring those competitive forces to bear. If advisors are operating under a beset interest standard, if we minimize the conflicts that they have, they incentives they have to choose one advisor over another, that they will in fact bring some of these competitive forces to bear in the retirement market.

And the UK's experience supports that as a reasonable outcome. This review, this latest review that's being conducted is not as I understand it some conclusion on their part, oh my gosh, what have we done. Rather, it's a broad review, the kind that industry is constantly asking for in the United States. We've made dramatic changes in our regulatory structure, how's that functioning. But what we've heard so far, and it's preliminary because this is new, is very positive news. And I think the message for DOL out of that is that they can afford to be bold. Now I say that as someone I don't particularly support banning commissions. I don't think there's one form of compensation that's all good or all bad. Everyone has conflicts. You can overcharge investors under any business model. If we can drive out some of these exacerbations of the conflict, these particularly abusive practices that increase the conflicts, then I think we can safely keep a commission based model in this area. It's a risk, but I think there are attendant

benefits with that that make it worth taking that risk.

MS. MOHRMAN-GILLIS: So I would just note, I mean I think some of the positive things that Barb discussed coming out the December 2014 analysis of the UK's experience so far, that's all great, but I think it's really important to remember that it is not appropriate to compare what the DOL has proposed with what the UK did. It's like comparing apples to oranges or something even more distinct than a category of fruit.

The bottom line is that the UK banned commissions, the DOL is not. The UK put in place more stringent competitive standards, the DOL is not. And the UK actually imposed increased regulatory fees, the DOL is not. They're two different things. The UK experience, as Barb said, there are some positive things out of banning commissions, but that's not what the DOL is proposing.

MR. MASON: I'd like to just sort of just go quickly through five facts and then one fruit thing. (Laughter)

MS. ROPER: You mean apples and oranges?

MR. MASON: Yeah, right. I just thought that was really appealing. So fact, when the RDR went into effect the four retail banks in the UK adopted the following policies: one -- and I'm converting pounds into dollars -- said you can't talk to us unless you have $80,000. Two, you can't talk to us unless you have $160,000. Three, you can't talk to us unless you have $800,000. And, four, you can't talk to us unless you pay us $800 for a financial plan. This isn't touchy-feely, I think things are going well, things are enhanced, these are facts. That is what happened in the UK. Second fact, the sort of excess capacity -- yes, that was in the DOL proposal. Oh, there's excess capacity. The next paragraph of that same report was omitted from the DOL analysis. And do you know what the next paragraph said? We didn't do any study as to whether the excess capacity is serving the low paid and we don't think it is. So, yeah, there's excess capacity, but they're not serving the low paid. Fourth, the DOL, in its own economic analysis, said two-thirds of advisors won't serve people under $31,000. They even admitted it in their own economic analysis. Fourth -- got I'm going to forget some of these

things, you know, when I sort of set out like this -- fourth, on the study that's going on right now the head of the RDR, the outgoing head, said we have one major problem. He didn't say we're doing a routine analysis. He said we have a major problem. This is a quote, "We have a major advice gap and that's why we're doing this analysis."

On the fruit issue, (laughter) if the BIC were usable, they would be apples and oranges. The BIC is not usable, therefore it's apples and apples, and we're going to have the exact same effect here.

MS. ROPER: I just have a couple of things. What he just described of not serving people if you have less than this amount, that's actually fairly common at the big broker-dealer firms today under a commission based model. There isn't a lot of appetite under any model for serving small accounts, but one thing that gets neglected in that, the big money in the retirement market is rollovers, small accounts, big accounts, that's how money is coming into retirement accounts today. You can't do rollover recommendations without relying on the rule. You'll either use the BIC or you'll walk away from billions of dollars that have been highly profitable for firms. So I think it's not going to be as easy for the firms to make this decision not to serve the market as being indicated.

The other thing is this argument about the rule isn't workable -- I mean I -- as indicated, we think there are changes that can be made to make the rule easier to implement, and we've supported that. But we hear this argument from industry all the time. You know, we heard it about fee based accounts when the SEC was considering regulating all fee based brokerage accounts as advisory accounts under the Advisers Act. Heard the exact same arguments. I mean you could pull the letters -- we did pull the letters from there. They make exactly the same arguments. Some of it is the same people. You know, if you do this we will stop serving those accounts, investors will lose access to valued services. You know, it's going to harm small savers. The SEC backed down -- big surprise. It got overturned in Court. Now all fee based accounts are advisory accounts regulated under the Investment Advisers Act subject to fiduciary duty. There is

more money in those accounts at broker-dealer firms that every before. They made the same arguments when they were going to deregulate commission. They make the argument that this is unworkable, this is going to harm small savers because it's a lot attractive, particularly when you're going up to visit members of Congress than saying, you know, we really, really, really just don't want to have to give up these practices that are really profitable for us, not so beneficial for our customers. (Applause)

MR. MASON: I want to read something here about the DOL rule. For example, we believe that industry concerns are probably justified that brokers might abandon the individual retirement account market if they're subject to ERISA's restrictions on third-party compensation.

MR. GOTBAUM: The "we" in this case is whom?

MR. MASON: I'm going to -- and it's tough sanctions for violations. This is Consumer Federation of America. So I don't know if anyone wants to clap for that point, for that abandonment.

MS. MOHRMAN-GILLIS: I don't know when that letter is from, but we did oppose the original 2010 rule proposal. We argued that it needed to be withdrawn and re-proposed because there wasn't clear guidance on -- oh, that's testimony -- there's wasn't clear guidance on what the prohibited transaction exemptions were going to look like, right. So we've talked about in all of this ERISA has a solely in the interest standard. So if you say we're going to put out this rule and everybody is going to suddenly be a fiduciary investment advisor, but you don't say what you're going to do through the prohibited transaction exemptions to make it possible for those commission earning advisors to operate under the rule, then yeah, it's a problem. As I said we have not supported the notion that we would ban commissions. So we argued that they needed to withdraw the rule, get rid of the seller's carve out by the way, which they did, and that they needed to provide the guidance on prohibited transaction exemptions so that we would know what the effect would be in the real world. That's what they've done and our position is based on the existing rule proposal.

MR. GOTBAUM: Right. Let me push the question about a level of certainty and how you get certainty under this BIC architecture. I thought it was amusing Kent said that he was not sophisticated and so he's called the contract by the name of a pen from a French company, but that's okay.

Jim Szostek makes the point that certain products like annuities are hard to explain, hard to sell, et cetera. And that that's part of the reason why his industry, in order to sell them, pays commissions to sales people to sell them. But it does raise the question of in a reasonable compensation regime who determines reasonableness? Is it a before the fact determination, is it an after the fact determination? So let's take this specific case, how to pose the regulation as implemented in its current form, how do people who are selling annuities figure out what they can charge?

MS. MOHRMAN-GILLIS: So I can start. I mean the concept that reasonableness, it is a facts and circumstances test, but if you do legal research you will see that there is case law that defines reasonableness in the context of ERISA. And it is defined based upon essentially compensation commensurate with that paid for similar products and services in the marketplace. That's one definition. So it's not that it's totally and completely undefined, number one. So number two, in terms of the notion that annuity products are more complicated, it takes more time to explain what they are and the benefits and all of the conditions, et cetera. The DOL recognized that category of products and services, there could be higher levels of compensation associated with certain products and services that take more time and expertise, et cetera, to make recommendations about. So it did not preclude the possibility for a higher level commission for an annuity product than say for the sale of a mutual fund.

Our sense is that you determined reasonable compensation by determining a range of compensation that is appropriate in the marketplace for the product given the services that are necessary to recommend or sell that product. So I would suggest that it's not just an amorphous term that is impossible to comply with and that -- you know, our folks all the time -- people who offer commission based services

under a fiduciary standard of care will go out in the marketplace and they will come back with a series of product recommendations from the marketplace, explain the different benefits and costs associated with those products so that the consumer can make a determination that is appropriate. So it's not an impossibility to provide fiduciary level services for an appropriate and reasonable compensation.

MR. GOTBAUM: With apologies for asking a nerdy question, but is there data as to what fraction of CFPs put their clients into annuity products before and after 2007?

MS. MOHRMAN-GILLIS: Right. No, I don't have data on that. We do have CFP professionals who operate under as I said insurance brokerage and advisory business models, but I don't have data on that.

MR. SZOSTEK: Josh, as I said in my opening, it's not that the insurance industry is fighting a best interest standard, it's about how this exemption operates. So the language in the exemption about "without regard to", "without regard to a sole interest." The tying of compensation, the tying of reasonable compensation for the total services provided would I think cause some problems for those doing asset managed fees. How do you justify the difference in compensation between an $85,000 account and a $90,000 account on one percent?

MR. GOTBAUM: Is this as simple as adopting your suggestion about reasonable and customary?

MR. SZOSTEK: It would help. It's not a perfect solution, but I think it moves us in a direction where at least we can defend ourselves a little better about what's taking place in the marketplace today and this is market based compensation. Again the Department of Labor I think is looking for outliers. I think, Barbara, you mentioned that. They're looking for, you know, what's the compensation practice that's unusual, that's driving somebody to do something unusual?

MS. MOHRMAN-GILLIS: No, I would say quite the opposite. Part of the problem here is that because the insurance regulators and the securities regulators have

failed to take any meaningful steps to reign in really abusive conflicts of interest in the compensation structures in those businesses, we need -- I mean it would be great if they would do it under those regulatory regimes as well, but we need customary -- there's too much pay right now that's customary, that's unreasonable. Beyond that, best interest --

MR. GOTBAUM: It is resulting in more sales? Does everyone have more annuities?

MS. MOHRMAN-GILLIS: Yes. They are clearly things that get sold based on the compensation that's earned rather than the best interest, yes. But let me --

MR. SZOSTEK: I'm not here to defend bad practices, and I'm not here to defend unusual compensation practices.

MS. MOHRMAN-GILLIS: I'm not talking about unusual compensation practices. I'm talking about the --

MR. SZOSTEK: In our ask to the Department of the Labor was to just focus on customary compensation practices.

MS. MOHRMAN-GILLIS: Right. And I'm saying we think there is a lot that's customary that's unreasonable. But beyond that, best interest without regard --

MR. SZOSTEK: But I'm (inaudible) reasonable and customary.

MS. MOHRMAN-GILLIS: Best interest without regard to is not solely in the interest, just to be clear. Solely in the interest --

MR. SZOSTEK: Without regard.

MS. MOHRMAN-GILLIS: -- means you can't have a conflict. Best interest without regard to means that you can have a conflict, but when you're deciding what's best for the customer you have to set your interests aside, you have to put that to one side of your mind and make an objective determination about what's in the best interest of the customer. It's the language that's taken out of Section 913 of Dodd-Frank.

MR. SZOSTEK: Which doesn't have a sole interest standard.

MS. MOHRMAN-GILLIS: It has a best interest without regard to.

MR. SZOSTEK: It doesn't -- it's not a sole interest. It's not a sole

interest standard to.

MS. MOHRMAN-GILLIS: That language is right from Dodd-Frank.

MR. SZOSTEK: Dodd-Frank is not sole interest.

MS. MOHRMAN-GILLIS: So then you're saying best interest without regard to is not sole interest?

MR. SZOSTEK: Dodd-Frank doesn't have prohibited transactions attached to it. It's a different regime.

MS. MOHRMAN-GILLIS: It was without regard to.

MR. SZOSTEK: But it's the regime you're talking about trying to apply a standard in a setting where I have a prohibited transaction if I receive compensation that doesn't fit within this exemption.

MS. MOHRMAN-GILLIS: You've got an exemption that allows that -- you got an exemption that says specifically you can get that compensation if you make recommendations that are in the best interest of the customer without regard to your own financial interest. That's the nature of the exemption.

MR. MASON: Josh, can I just -- you know, it's funny, you know, I mean I think one of the sad parts -- and I'm going to try really hard to sort of find something where the four of us can agree. And I don't really think I'm going to succeed.

MR. GOTBAUM: It's Friday. Other than that we're going to end in five minutes.

MR. MASON: No, that's good. I know, I know (laughter), but I want to find -- you know, I sort of want to go off on the weekend with something, you know, upbeat. (Laughter) So maybe that's really silly, but, you know, it's funny because I was listening to both of you and I think to myself you both want a BIC that works. I mean you clearly do. And so I think that sort of -- I think part of what we -- and this process I will say, you know, my observation and I don't discount sort of both sides parts in this because I don't think either side is sort of innocent in this regard, it's been polarized, it just has been. And so to me I mean we can sort of figure out how best to articulate a

best interest standard. We can figure out the words that would sort of do that. And I just don't think at the end of the day if we sat down for an hour we could sort of work that out. So I think that's good.

And, you know, on the BIC, you know, I was listening to you (inaudible) was saying well, gee, you know, disclosure is worthless so why are you depending on disclosure. Well, you know, part of our frustration on the industry side is this proposal requires more disclosure than any proposal in history. And I'm not exaggerating here, it is staggering. And so we read the preamble that says disclosure is worthless, and then we read the proposal that says we have more disclosure than anything in history, we kind of think can't we work this out, you know. Can't we come up with something simple and short because, you know, like on the -- you know, sort of like the example you've sort of worth $30,000 if you don't want to (inaudible) $200. We're not in favor of that, we're not in favor of that structure. What we want is something that we can do, something that we can sort of comply with and then we go -- you know, and then, you know, the really wonderful thing is I don't (inaudible).

MS. MOHRMAN-GILLIS: So let me just -- let me (inaudible) broad concept.

MR. MASON: I mean that's a wonderful thing. That's what I say to the Hill. Look, if you do this I'd go away. (Laughter)

MS. MOHRMAN-GILLIS: Broad concept. Best interest, obligated, a binding obligation, disclosure, and that the principle of the disclosure is the compensation, the cost of the products and the services, the full cost, not just the -- and the compensation being paid to the advisor and to the firm. So the --

MR. SZOSTEK: It's where the details are, but I mean I'm totally with you conceptually.

MS. MOHRMAN-GILLIS: So those are some of the key principles. And I think that one of the things that I've found so fascinating in the hearings, and it was over and over and over again, so every single person who testified basically, we believe in the

best interest standard. And then Tim Hauser, who I thought was really quite remarkably restrained in the --

MR. GOTBAUM: Principal Deputy Assistant Secretary at the Department of Labor. The current civil servant who has to worry about all of this.

MS. MOHRMAN-GILLIS: -- would say -- would say -- I did, I did actually -- would say okay, well let's try to talk about the concept behind the BIC, which is essentially I'm obligating to put my client' best interest, to serve my client's best interest, and I am going to legally obligate myself to do that. Can you do that? And virtually every single industry witness said no, we can't do that. And Tim would say, why?

MR. MASON: Obligated to do what? To do what?

MS. MOHRMAN-GILLIS: To put my client's best interest first.

MR. MASON: I was there and I said find to that.

MS. MOHRMAN-GILLIS: With a legal, contractual obligation.

MR. MASON: What I said to them -- and I will tell you what I said to them because it's actually a matter of public record, is that there are a number of companies in the industry that are absolutely fine with that, there are some that have concerns with that contract. But they're not -- they don't have a problem with the best interest concept. The ones that sort of -- and I don't know what the split is between, but some are fine with the contract. Some say we don't like the state law class actions. That's what they say.

MR. GOTBAUM: Right. Kent, we --

MR. MASON: Go ahead, Josh.

MR. GOTBAUM: We were planning to have questions from the audience, but we have actually run through our time. So to the extent that the panelists are willing to stick around, I'll let them impose on you.

But first of all I think we owe a round of applause to thank these folks for doing this (applause), because they to a surprising degree I will tell you given their very, very strong views about this, have stayed within the four corners of what we at Brookings

hoped would be an informed --

SPEAKER: A civil discourse.

SPEAKER: Fantastic job, fantastic job.

MR. GOTBAUM: -- civil discussion.

SPEAKER: Thank you all. And thank you, Josh, also.

MR. GOTBAUM: Thank you very much.

SPEAKER: Thank you to the audience. (Applause)

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