# Pension Equity:

## ‘Investment Advice’ Provision = Conflict of Interest

> "This legislation opens a loophole that will sharply erode, rather than enhance, safeguards for employees seeking independent and untainted advice about how to invest their retirement savings. Clearly, this bill puts the interests of Wall Street firms far ahead of the interests of millions of working Americans who simply want a fair shake in making sound decisions about their retirement investments."
>
> -- New York State Attorney General Elliot Spitzer, May 13, 2003

**H.R. 1000, the Pension Security Act of 2003, Creates A New Loophole in Pension Protections that Only Ken Lay and Special Interests Could Love.** The key feature in the House-passed pension “reform” bill would open a new, dangerous loophole that jeopardizes employee’s savings. Current law prohibits employers from offering “*conflicted advice*” – where consultants profit from the investment decision they suggest to employees.

Violation of these “conflicted advice” protections is one of the major reasons why officials at Wall Street firms like Merrill Lynch, Salmon Smith Barney, and others, are in trouble. New York State Attorney General Eliot Spitzer has testified about the conflicts of interests by Merrill Lynch that caused billions in losses for individual investors: "Even as stocks plummeted, the 'buy' recommendation on investment banking clients remained firm. Individual investors who depended on Merrill Lynch stock analysis and investment advice were misled, and left to rely on stock rating skewed to please investment banking clients. In short, a major Wall Street firm exploited its massive retail client base as a tool for bringing in new business."

**Despite one Wall Street scandal after another, Republicans have inserted a provision to make conflicted investment advice legal.**

**The Centerpiece of the Republican Bill Reverses Pension Protections and Allows Conflicted Advice**. The bill would allow investment firms hired at the behest of employers to offer conflicted investment advice to employees and steer them into buying or holding their own investment funds, generating fees for themselves, sometimes at the expense of the employee.

Employees need **independent** investment advice so they do not continue to over invest in their own companies (while executives are privately dumping their own stock).

- **Independent Experts Warn Against Opening up A New Loophole**. During the Clinton Administration, Labor Secretary Alexis Herman adamantly opposed creating a new loophole for special interests: "***Such a broad exemption raises the potential for serious abuse of the self and conflict of interest provisions"…and "would place the risk of bad investment advice squarely on the participant."***

- Professor Dan Muir of the University of Michigan recently commented in a law review article that the passage of the new loophole would require the Labor Department, the courts and Congress to provide workers relief "***from the horror stories that are sure to occur" from the Republican bill's "inadequate remedies" against "fraudulent or negligent advisors."***

- Jane Bryant Quinn, the nationally acclaimed author on personal investment advice, in a March 4, 2002 Newsweek column, sharply critiqued the Republican bill: **"Post-Enron how can anyone even think of creating such conflicts of interest? You might as well turn the system over to an ice-skating judge…".** And again in the August 19th issue of Newsweek, Quinn writes**: "The House thinks it's OK to use the same company that provides the mutual funds for the 401(k). To me that's a conflict of interest, with plenty of dangers down the road. The Senate bill would require independent advice from companies not involved with the funds".**

- The Inspector General of the Department of Labor, has also raised serious concerns regarding the new pension loopholes failure to provide minimum safeguards regarding investment advisors: ***"H.R. 3762 does not contain provisions relative to fiduciary adviser qualifications…The Department of Labor and plan participants would be in a better position to monitor and oversee the advice given if minimum standards for qualification and disclosure were established."***

- The Financial Planning Association has raised serious questions about the ability of the Department of Labor to oversee investment advisors and protect investors. The Association concludes, **"The breadth of the new [investment advice] exemptions may simply lead to a significant increase in claims of imprudent advice, inadequate disclosure, and other investor suitability problems."**

**Disclosure of Complex Conflicts of Interest Fail To Protect Workers.** Even sophisticated institutional investors found it impossible to untangle the web of conflicts of interest in the financial statements disclosed at Enron and WorldCom. Employees cannot be expected to possess the detailed expertise needed to untangle complex conflicts. In fact, the SEC has sought to strengthen existing financial disclosures by investment advisors because it found that average investors are often mislead by highly technical and complex disclosures, and the information provided is too frequently outdated.

**Without Protections, Investment Firms Will Steer Employees to Their Own Product**. On September 3rd, 2002, *The Wall Street Journal* published a story entitled "Schwab Gives Own Funds Top Billing on 'Short List.'" The WSJ reported that Charles Schwab – which publicly touts independent investment advice – had skewed its recommended investments list in favor of its own funds. "Schwab and other such marketers usually make more money from in-house funds they sell to investors. When they sell funds managed by a different company, they get only part of the management fees. So it isn't surprising a company would seek to sell its own funds. But Schwab has gone to great lengths in advertisements to trumpet its independence from conflicts of interest so common on Wall Street. An effort to prominently boost its own funds on a special short list could backfire, some fund-marketing experts say."

**Arthur Levitt is also warning us about another conflict of interest** in his book, **Take on the Street**, that threatens worker retirement savings. Levitt writes:

> *"… I have reservations when [investment] advice comes from the very same mutual fund company whose products are for sale to a plan's participants. One of my bedrock principles of investing is that advice should come from neutral parties with no ax to grind."*

Levitt also makes clear what special interests have at stake in the investment advice bill:

> *"The [Republican] legislation would give [mutual funds] access to a new and potentially very lucrative source of revenue -- the $1.8 trillion in employee 401k accounts, 40 percent of which in invested in mutual funds."*

And most recently, the **Washington Post** reported on concerns that U.S. Senators have about the ability of Wall Street to police itself.

## Senators Cast Doubt on Self-Policing By Wall Street : Shelby, Sarbanes Say More Has to Be Done

By Kathleen Day, Washington Post Staff Writer
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Two powerful senators yesterday questioned Wall Street's ability to police itself, saying that inherent conflicts of interest require a review of decades-old federal policy that gives the securities industry frontline responsibility for regulating its members.

"Those conflicts need to be exposed," said Senate Banking Committee Chairman Richard C. Shelby (R-Ala.). "And they need to be gotten rid of."

"How adequate are the self-regulatory mechanisms on which our securities markets rely?" said Sen. Paul S. Sarbanes of Maryland, the committee's top Democrat. "The way it's been working hasn't been working."