VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS
AND INDEPENDENT FINANCIAL ADVISORS

Testimony of
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Subcommittee on Health, Employment, Labor, and Pensions

On

"Restricting Access to Financial Advice: Evaluating the Costs and Consequences for Working Families and Retirees"

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Introduction

Good morning, Mr. Chairman, Ranking Member Polis, and members of the Subcommittee. I am Dean Harman, Founder and Managing Director of Harman Wealth Management in The Woodlands, Texas. I am a CERTIFIED FINANCIAL PLANNER™ with over 20 years of experience in the financial services industry. I am here representing the Financial Services Institute (FSI). FSI is the only organization advocating solely on behalf of independent financial advisors[1] and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has successfully promoted a more responsible regulatory environment for more than 37,000 independent financial advisors, and more than 100 independent financial services firms who represent upwards of 160,000 affiliated financial advisors. We effect change through involvement in FINRA governance as well as constructive engagement in the federal and state regulatory and legislative processes, working to create a healthier regulatory environment for our members so they can provide affordable, objective advice to hard-working Main Street Americans.

Independent financial advisors, such as me, are in the business of helping hard-working Americans achieve their financial goals. This entails helping our clients plan for a dignified retirement, pay for their children's education, support loved ones in old age, deal with healthcare issues, and the many other life situations that require financial resources. In my practice, approximately 60% of the accounts that I service are retirement accounts. Furthermore, approximately 90% of the accounts that I service are under a fee-based advisory model. The other 10% are accounts that I service under a commission-based model. These commission-based accounts belong to smaller investors, including the elderly and many young adults who are just starting their careers, who need the advice, products and services I can provide.

As our retirement system has moved towards a defined-contribution model and traditional pensions are becoming a thing of the past, it is critical that these lower net-worth investors be able to obtain professional guidance as they prepare for retirement. It is because of this that I am here today. I want to ensure that any rule written by the Department of Labor (DOL), or any

[1] The term "financial advisor" is used to denote registered representatives of broker-dealers, investment adviser representatives of investment advisers, and persons who are dually registered in both capacities.

other regulator in the retirement savings sphere, will make it easier, not harder for investors to receive high-quality, retirement services from a trusted financial advisor.

My testimony will touch on three main points. First, FSI and many independent financial advisors support a uniform fiduciary standard. Second, the current DOL proposal regarding the definition of the term "fiduciary" for purposes of the Employee Retirement Income Security Act of 1974 (ERISA) is based on flawed assumptions that lead it to be too complex, too cumbersome, and too costly. Finally, because of these shortcomings, FSI and I believe that the DOL's proposal will result in small- and mid-sized investors losing access to the retirement advice and products that they need to secure a high-quality of life in their retirement years.

DOL's Proposed Rule Creates Vast, Sweeping Changes to the Retirement Savings Landscape

On April 20, 2015, the DOL published its proposed rule on conflicts of interest and the definition of the term fiduciary under ERISA. The DOL previously attempted to pass a similar regulation in 2010. Because of concerns expressed by the industry and Congress, DOL withdrew its previous proposal on September 19, 2011. However, they promised to issue another proposal. To their credit, the DOL took its time and attempted to address the concerns with the 2010 proposal raised by the industry and Congress. Unfortunately, while the proposal being discussed today is one that looks and functions very differently from the 2010 proposal, it delivers virtually the same results – an unworkable, complex and costly rewrite of ERISA and IRS regulations that will harm retirement investors more than it helps them.

DOL's proposal would institute a broad new definition of the term "fiduciary" for the purposes of ERISA. Under this new proposed definition, an individual who provides investment advice or recommendations to an employee benefit plan, plan fiduciary, plan participant or beneficiary, IRA, or IRA owner would be treated as a fiduciary in a wider array of advice relationships than under current requirements. Under this much more expansive definition, more advisors will be considered fiduciaries when providing services to retirement savers. This is an extremely important change because fiduciary status brings with it prohibitions and limitations on compensation and other arrangements that are essential to those who service retirement accounts.

Under current laws and regulations that have been in place since 1975, a person who does not have discretionary authority or control with respect to the assets of a plan will not be treated as a fiduciary by virtue of providing investment advice unless:

1) Such person renders advice as to the value of securities or other property, or makes recommendations as to the advisability of investing in, purchasing or selling securities or other property;
2) On a regular basis;
3) Pursuant to a mutual agreement, arrangement or understanding, with the plan or a plan fiduciary;
4) That the advice will serve as a primary basis for investment decisions with respect to plan assets; and
5) The advice will be individualized based on the particular needs of the plan.

The DOL proposal would eliminate this current five-part fiduciary test. In its place, the proposal would institute a vastly expanded fiduciary definition. Under this proposed rule, an advisor would be deemed a fiduciary if two different conditions are met.

First, the individual receives a direct or indirect fee for providing directly to a plan, plan fiduciary, plan participant or beneficiary, IRA, or IRA owner any one of the following:

- A recommendation as to the advisability of a plan investment holding or transaction, including a recommendation to take a distribution or as to the investment of a rollover of that distribution;
- A recommendation as to the management of securities or other property;
- A verbal or written appraisal, fairness opinion, or similar statement concerning the value of securities or other property in connection with a specific transaction; or
- A recommendation of a person to provide, for a fee, any of the above three services.

Second, the individual directly or indirectly represents or acknowledges that he/she is acting as a fiduciary, or he/she renders the advice pursuant to a written or verbal agreement, arrangement, or understanding that the advice is either individualized or specifically directed to the recipient for consideration in making investment or management decisions with respect to plan or IRA securities or property.

Not only does this new definition expand the activities that would render an individual a fiduciary, but it also expands the universe of accounts that are covered by the regulation to include IRAs and other accounts such as HSAs that were previously not considered to be under ERISA's umbrella. The proposal does provide eight narrow carve-outs to the above definition. Unfortunately, these carve-outs tend to be so narrowly tailored that they are of little to no help to most financial advisors.

Because of the expansive definition and the narrow nature of the carve-outs, the vast majority of interactions that a financial advisor, whether registered with a broker-dealer or investment adviser firm, will have with plans, plan fiduciaries, plan participants or beneficiaries, IRAs, or IRA owners would fall under the new fiduciary definition.

As ERISA fiduciaries, financial advisors are prohibited from receiving variable compensation or commissions unless an exemption applies. Under the proposal, a fiduciary advisor may still receive these types of compensation if the advisor's activities fall under one of the Prohibited Transaction Exemptions (PTEs) like the newly proposed Best Interest Contract Exemption (BICE).

The DOL has stated its intention is for BICE be the primary method by which advisors and firms would be able to receive otherwise prohibited compensation for services provided in connection with the purchase, sale, or holding of an asset subject to the proposed fiduciary standard. BICE would require that both the financial advisor and the firm enter into a pre-advice, pre-point-of-sale contract with a potential investor. In this contract, the financial advisor and the firm would have to make various warranties and acknowledgements to consumers that amongst other things include: acknowledging their fiduciary status; agreeing to provide advice that is in the best interest of the investor; agreeing to not recommend assets when compensation for those assets would exceed "reasonable compensation;" and disclosing any conflicts of interest.[2]

[2] The full contract requirements are as follows: the advisor and the firm acknowledge that they are fiduciaries; the advisor and the firm agree to provide advice that is in the best interest of the investor and will not recommend an asset if the total compensation would exceed "reasonable" compensation for the total services provided; the advisor and the firm agree to not make misleading statements regarding the asset, fees, conflicts of interest, and any other matters related to investment decisions; the advisor and the firm warrant that they will comply with all applicable federal and state laws, the firm has adopted written policies and procedures to mitigate conflicts of interest, the firm has identified all potential conflicts of interest and has adopted measures to prevent the conflicts from impeding the advisor and the firm from providing advice that is in the best interest of the investor, and the firm and its affiliates (to the firm's knowledge) do not engage in practices that encourage advisors to not provide advice that is in the best interest of the investor; any conflicts of interest have been identified and disclosed; the investor be advised of the

Furthermore, while the contract may call for arbitration of individual claims, it may not contain any provision disclaiming liability from a violation of any contractual term or any waiver or qualification of the investor's ability to enter into a class action suit against the financial advisor or the firm for any violation of the contract's terms.

Along with the contract briefly summarized above, BICE also contains various onerous disclosure, website, and recordkeeping requirements, as well as a list of approved investments that may be sold to retirement accounts. In a later section, I will dive further into these requirements and explain various troublesome aspects of BICE and its multitude of costly requirements.

I wish to emphasize that my concern, and the concern of FSI members, is not that DOL's proposal would expand the universe of retirement advice interactions that would be held to a fiduciary standard of care. Both FSI and I believe that a carefully-crafted, uniform fiduciary standard of care would be beneficial for investors, so long as it preserves the business and fee models that make it possible for all Americans to receive affordable retirement and other financial advice. Instead, our concern lies with all of the additional requirements contained in the proposal that would create serious disruptions to the retirement savings landscape and make the proposal unworkable for retirees, financial advisors, and financial institutions. These extra requirements will drive up costs and will make it more difficult for me, and countless other advisors, to provide retirement advice to the millions of Americans that have modest retirement savings accounts. Without access to these services, I fear that many Americans will delay investing for retirement, respond emotionally to fluctuations in the markets or cash out their retirement savings to satisfy short-term needs. Most especially, I fear for my own low net-worth clients who I could no longer service under the new requirements.

FSI Supports a Uniform Fiduciary Standard

Since 2009, FSI has publicly supported a carefully-crafted, uniform fiduciary standard of care applicable to all professionals providing personalized investment advice to retail clients.

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right to complete information regarding all fees associated with the asset; and there be a disclosure as to whether the firm offers proprietary products or receives indirect compensation, and directs the investor to a publically-available website where the information can be viewed.

While our industry is already held to high standards of care and there is a robust enforcement regime to ensure that we are working properly on behalf of our clients, there is a lack of uniformity with regards to the standard of care that different advisors must adhere to when advising clients. Because of this, FSI supports the creation of a uniform fiduciary standard of care that would be applicable to all advisors and all asset classes.

Advisors all over this country have worked hard to grow their businesses and help their clients. We are in a business that is built on a foundation of trust. Our clients trust us to help them reach their life goals and help them weather the difficult moments in their lives. We are in a service profession and we take immense pride in being entrusted to help our families, our friends, our neighbors, our colleagues, and other members of our communities. Having these people's financial hopes and dreams placed in our hands also gives us a deep sense of responsibility. It is because of this pride and responsibility that we hold ourselves up to high standards and we would welcome further codifying our commitment to our clients through a uniform fiduciary standard of conduct. This uniform standard of conduct should consist of the following:

- A professional should act in the best interest of the customer;
- A professional should provide advice with skill, care, and diligence based upon information that is known, about the customer's investment objectives, risk tolerance, financial situation, and other needs;[3] and
- A professional should disclose material conflicts of interest, avoid them when possible, and obtain informed customer consent to act when such conflicts cannot be reasonably avoided.

The standard of care described above is designed to address the same investor protection goals that have motivated the DOL to release the proposal that the Subcommittee is analyzing today and it goes a step further by making this the standard for advice regarding all investment products, not just retirement savings. There are two other key differences between this uniform fiduciary standard of care and the DOL proposal – (1) this uniform fiduciary standard of care would not create the same disruption to the current retirement savings marketplace, and (2) it

[3] FSI believes that a financial advisor should use reasonable diligence to obtain the necessary information to provide advice.

would give advisors and firms the necessary flexibility to make the proper decisions regarding what investments and payment models are in the best interest of each individual client.

What I have outlined is truly a principles-based approach to investor protection, whereas the DOL proposal is one that is overly-prescriptive in its approach. Advisors need the flexibility to treat each client as an individual and tailor investment strategies that meet a client's specific circumstances. Flexibility in investment strategies and compensation structures allows me to develop unique investment plans for each and every one my clients. Should the DOL proposal be implemented, as currently proposed, I fear that much of this flexibility will be gone and I will be unable to provide retirement advice to all of my clients, especially those with lower balances in their retirement accounts.

The DOL has premised its proposal on flawed assumptions made about financial advisors, the financial services industry, and retirement savings products

In crafting its proposal, the DOL has made several flawed assumptions regarding our industry and the retirement savings products commonly used by investors. These assumptions cause the proposal to include additional requirements that I believe will prove to be too complex, too cumbersome and costly. These extra requirements will drive up costs and will make it more difficult for me, and countless other advisors, to provide retirement advice to the millions of Americans that have modest retirement savings accounts. I want to highlight three of the most troublesome misunderstandings that have colored the DOL proposal.

First, the proposal is premised on a belief that retirement investors are unprotected by the current regulatory system. This is simply not true. My business is heavily regulated by the Securities and Exchange Commission (SEC), the Financial Industry Regulatory Authority (FINRA), and 50 state securities regulators. Furthermore, my broker-dealer also routinely monitors my activities and examines my business to ensure that I am in compliance with the many rules and regulations that I am subject to as a financial advisor. Adding new levels of regulatory requirements and legal burdens on to this structure, as this proposal does, will not further protect investors. Instead, it will drive up compliance costs on financial advisors and, ultimately, drive up the costs of retirement advice for investors.

Second, the DOL has stated that "conflicted advice" causes consumers to lose approximately $17 billion on an annual basis. In reaching this conclusion, the DOL relies on an unreliable figure from a report published by the White House Council of Economic Advisers.[4] The figure is an estimate that is not directly found in any academic research and is an estimate calculated by the authors of the report. In arriving at this estimate, the authors of the report make largely unsupported generalizations and extrapolations. Their calculation is a simplistic one where they take the total value of load mutual funds in IRAs and the total value of annuities in IRAs, and multiplying that number by their estimated losses to consumers of 1% per year due to "conflicted advice."

This approach is flawed in the following ways: (1) academic literature suggests a more nuanced and complex set of findings than the simplistic claim of 1% in annual losses; (2) the academic studies that the report's authors rely upon only look at the first year of a fund's performance, when costs are highest; and (3) the report ignores the value to consumers added by brokers in the form of customer service, broader diversification, risk reduction, and other intangible benefits. Furthermore, the figure does not provide a true cost-benefit analysis because it only looks at the supposed costs to consumers of "conflicted advice." The study's authors did not take into account what would happen to the retirement savings marketplace if the DOL proposal is put into place. Therefore, the DOL is unable to quantify what positive and/or negative effects will result from the rule proposal.[5] By using such an unreliable figure to justify the need for the proposal, the DOL is doing a disservice to investors, especially those of modest means who will benefit from professional advice when planning for retirement.

Third, the DOL proposal assumes that financial advisors direct their clients to the highest priced investment options to line their pockets to the detriment of their clients. As a financial advisor, I can tell you that isn't how my practice, or those of my fellow financial advisors, operates. But you don't have to take my word for it. Investment Company Institute research demonstrates that the opposite is true. Financial advisors tend to lead investors to funds whose

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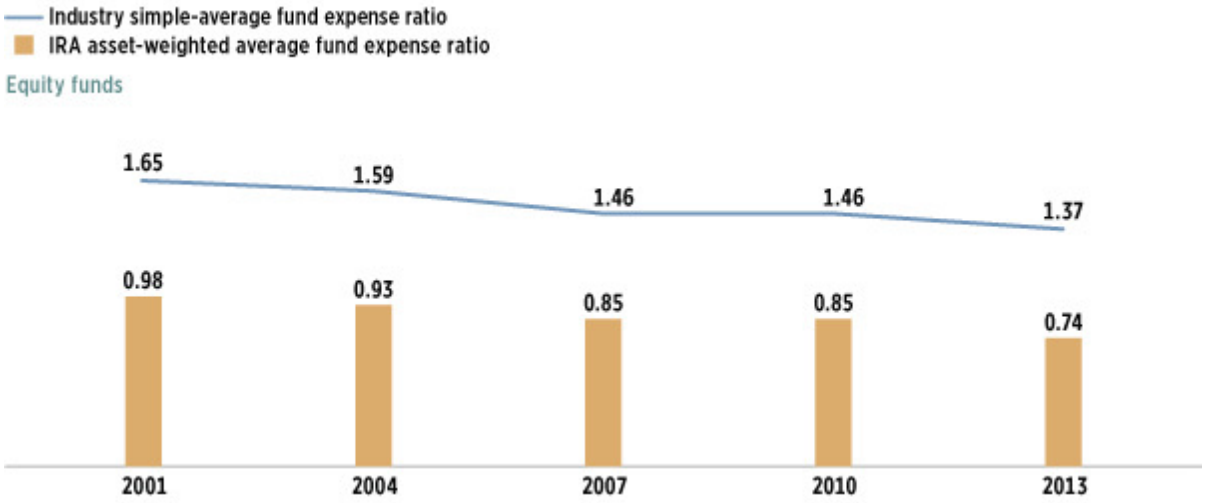
[4] Council of Economic Advisers, *The Effects of Conflicted Investment Advice on Retirement Savings* (February 2015), *available at* https://www.whitehouse.gov/sites/default/files/docs/cea_coi_report_final.pdf.

[5] For a more detailed analysis of the shortcomings Council of Economic Advisors' report, See, Berkowitz, Jeremy, et. al., *Review of the White House Report Titled "The Effects of Conflicted Investment Advice on Retirement Savings,"* NERA Economic Consulting (March 2015), *available at* http://www.nera.com/content/dam/nera/publications/2015/PUB_WH_Report_Conflicted_Advice_Retirement_Savings_0315.pdf.

expense ratios are far lower than the average expense ratio for all funds.[6] The following chart demonstrates the point:



Unfortunately, these and other flawed assumptions cause the DOL to offer a proposal that is poorly designed for investors and unduly burdensome for financial advisors and financial institutions. The result is that the proposal will drive up costs putting retirement advice out of the reach of many investors.

The DOL Proposal Will Inhibit Financial Advisors' Ability to Provide High-Quality, Individualized Retirement Advice

When looking at implementing any potential final rule in this space, it is imperative that the DOL ensure that all investors maintain affordable access to the significant benefits that financial advisors provide. Investors working with a financial advisor to save money for retirement are better positioned to reach their goals than investors that choose to forge their own investment path. This is because advisors are able to focus investors on their long term goals and help them navigate the many different and complex ways by which investors can save for both long- and short-term goals. This focus helps investors weather the ups and downs that accompany

[6] Letter from David Abbey and Brian Reid, Investment Company Institute, to Howard Shelanski, Administrator, Office of Information and Regulatory Affairs, Office of Management and Budget (April 7, 2015), *available at* http://www.ici.org/pdf/15_ici_omb_data.pdf.

our financial markets, thus preventing investors from chasing returns, buying high and selling low, and making rash emotional decisions during both bear and bull markets. Financial advisors also assist investors in resisting the temptation to cash out their retirement accounts to meet short-term needs.

There have been many studies conducted that demonstrate the positive impact of financial advisors working with investors, especially with regards to building retirement savings. Here is a small sampling of these studies:

- According to a 2012 study by the Investment Funds Institute of Canada[7] and a 2010 survey by the ING Retirement Research Institute,[8] individuals who spent at least some time working with a financial advisor had saved, on average, more than twice the amount for retirement than those that had not worked with an advisor.
- An April 2014 study by Quantria Strategies found that retirement savings balances are 33% higher for individuals who have access to financial advice; employees are less likely to take cash withdrawals out of their retirement savings if they discuss their distribution options with an advisor; and limiting access to this assistance could increase annual cash outs of retirement savings for employees leaving a job by $20-32 billion, thus reducing the accumulated retirement savings of affected employees by 20-40%.[9]
- A 2012 survey conducted by LIMRA found that investors working with an advisor are more likely to be saving for retirement at higher rates (defined as contributing more than 7% of their salary to a retirement plan) with 61% of investors who worked with an advisor saving at the higher rates compared to 36% of investors that were not working with an advisor.[10]

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[7] Cockerline, Jon, *New Evidence on the Value of Financial Advice*, The Investment Funds Institute of Canada, 2012, *available at* https://www.ific.ca/wp-content/uploads/2013/08/New-Evidence-on-the-Value-of-Financial-Advice-November-2012.pdf/1653/.
[8] ING Retirement Research Institute, *Working with an Advisor, Improved Retirement Savings, Financial Knowledge and Retirement Confidence!*, 2010, p. 6, *available at* http://voyacdn.com/file_repository/5151/help_wanted_wp.pdf.
[9] Quantria Strategies, *Access to Call Centers and Broker Dealers and Their Effects on Retirement Savings*, April 2014, *available at* http://quantria.com/DistributionStudy_Quantria_4-1-14_final_pm.pdf.
[10] LIMRA, *Advisors Positively Influence Consumers' Behavior and Sentiment Toward Preparing for Retirement*, July 2012, *available at* http://www.limra.com/Posts/PR/News_Releases/LIMRA__Advisors_Positively_Influence_Consumers__Behavior_and_Sentiment_Toward_Preparing_for_Retirement.aspx.

- A 2010 study by Prudential found that African Americans with a financial advisor were significantly more likely to participate in employer sponsored retirement plans, have a savings account, life insurance, long-term care insurance, annuities, and mutual funds. That same study also found that African Americans who worked with a financial advisor were more financially confident than those who did not.[11]

- A 2013 Morningstar study found that by working with a financial advisor, a retiree can be expected to generate 22.6% more certainty-equivalent[12] income. This has the same impact on expected utility as an annual return increase of 1.59%, which represents a significant improvement in portfolio efficiency for a retiree.[13]

- A 2012 study conducted by the Investment Funds Institute of Canada found that households working with an advisor have substantially higher investible assets than non-advised households, regardless of household income level, because advisors helped investors choose the right plans and asset mix to fit their individual circumstances, objectives, and risk tolerance.[14]

Unfortunately, the DOL appears to have been unaware of these positive effects or the importance of ensuring that all investors, regardless of their wealth, retain access to professional retirement advice.

I do not question the DOL's intentions. Protecting investors is a laudable goal and one that FSI and I share, but no matter how well-intentioned the DOL is in this matter, their proposal has severely missed the mark and it will lead to millions of Americans losing access to retirement advice. FSI does not want to see this happen, which is why we have been involved in constructive dialogue with the DOL to try and improve their proposal so that it achieves their investor protection goals in a manner that is truly workable for all parties.

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[11] Prudential, *The African American Financial Experience* (2014), *available at* http://www.prudential.com/media/managed/aa/AAStudy.pdf.
[12] Certainty-equivalent is defined as a guaranteed return that an investor would accept, rather than taking a chance on a higher, but uncertain, return.
[13] Blanchett, David and Kaplan, Paul, *Alpha, Beta, and Now...Gamma*, Morningstar Investment Management, August 2013, p. 16, *available at* http://corporate.morningstar.com/ib/documents/PublishedResearch/AlphaBetaandNowGamma.pdf.
[14] The Investment Funds Institute of Canada, *The Value of Advice Report*, 2012, *available at* https://www.ific.ca/wp-content/uploads/2013/02/IFIC-Value-of-Advice-Report-2012.pdf/1650/.

The following are our biggest concerns with the proposal – the areas where we feel the proposal will do the most harm to investors and their access to retirement advice, products, and services. These are areas that must absolutely be fixed if this proposal is going to work as we believe the DOL intends it to work.

The proposal is too restrictive with regards to what activities are permissible "investor education" activities.

One of the most important aspects of my job as an independent financial advisor is improving the financial literacy of my clients and those in the community that I serve. For people to make educated decisions regarding their financial futures, it is imperative that they are given a solid foundation of understanding. Too many individuals do not have this foundation. Many do not know the difference between a growth and a fixed income mutual fund or do not understand the need to diversify their portfolio to reduce risk. Sadly, there are many people in this country that have never been taught the basics of investing.

There are few places where the effects of a lack of financial education can be more harmful than in the retirement savings sphere. For decades, large sections of our nation's workforce did not need to be concerned with how they would fund their retirement years. The twin pillars of the pension and Social Security systems provided millions of Americans piece of mind. They knew that if they worked hard, then they would be able to enjoy their retirement years. All of that has changed in today's world. The pension system now represents a small fraction of the retirement model for the American workforce. It has been replaced by a defined-contribution model where individuals now bear a greater responsibility for funding their retirements. Furthermore, as Americans are living longer lives, it takes more money to live comfortably in retirement. This means that, now more than ever, it is critical that Americans are given the proper tools and information to make informed decisions. Therefore, any regulation in the retirement savings sphere must make it easier for individuals to receive vital education regarding their investments and retirement savings.

In some ways the DOL's proposal achieves this goal. Under current regulations, as stated in DOL Interpretive Bulletin 96-1,[15] advisors have a hard time being able to clearly illustrate longevity risks and the effects of "decumulation" on retirement savings. In this instance, the DOL

[15] *Interpretive bulletin relating to participant investment education*, 25 C.F.R. § 2509.96-1.

listened to feedback from advisors and other industry representatives regarding the 2010 proposal. It is great to see that the DOL made a positive improvement from its prior proposal and have made it clear in this version that educational materials regarding longevity risks and the effects of "decumulation" are allowable as "investor education" pieces.

Unfortunately, not all of the DOL's proposed changes to the "investor education" carve out are positive. One of the most significant negative changes to "investor education" lies in the proposal's prohibition on referencing specific investment products in educational pieces. This change will lead to investors having less knowledge regarding their investment options. In my practice, I use asset allocation models and other similar illustrations to show plan participants, current, and potential clients how they can diversify their portfolios to manage risk. To a great extent, investor comprehension is contingent upon being able to identify what funds or other investment options available to them align with a category of investment. By removing the ability for me and other advisors to provide the proper context on these education materials, the DOL will be curtailing the effectiveness of these important educational resources. Sadly, this will likely lead to confusion among investors and a decrease in the overall financial knowledge of individuals when making important decisions regarding their retirement investments.

BICE is rife with problems and will not serve its intended purpose unless it is substantially altered.

Beyond the problems with "investor education," the DOL proposal has fundamental flaws at its core that make it currently unworkable for advisors, such as me, and the rest of the financial services industry. I want to focus in on the BICE, which the DOL has crafted with the intention of preserving compensation models, such as commissions, that many advisors and firms rely upon when providing retirement advice to small accounts.

First, let me give a brief explanation of why it is important that these compensation models be preserved. In my practice, I currently advise 618 clients whose accounts have a total of approximately $200 million in assets. Of those total assets, approximately $10 million are held in 331 different accounts that have an average of around $30,211.[16] These typically are the accounts that benefit from a commission-based account. For these accounts, it makes no sense for me to be paid under an advisory fee model because the asset management fee would be

[16] Nearly 40% of IRAs in a 2010 survey conducted by Oliver Wyman had less than $10,000. *See*, Oliver Wyman, *Assessment of the impact of the Department of Labor's proposed "fiduciary" definition rule on IRA consumers*, April 2011, *available at* https://www.dol.gov/ebsa/pdf/WymanStudy041211.pdf.

cost-prohibitive for the client. Because these accounts are mainly owned by lower net-worth clients, young professionals just beginning their careers, and the elderly, these individuals cannot afford to come out-of-pocket to pay up-front financial planning fees for my advice. A commission-based model eliminates, or significantly reduces, these issues, thus providing a way for small to mid-size investors to pay for the advice, products, and services they need in a way that makes economic sense for these individuals. Because of this, I, and countless other advisors, recommend commission-based accounts for many younger or lower net-worth investors.[17]

In 2010, the DOL proposed a complete ban on commission payments on retirement accounts. Thanks to their willingness to listen to the many concerns regarding that approach, the DOL's current proposal does not repeat that mistake. The DOL has created a new exemption, BICE, with the intention that it be the primary method by which advisors and firms would be able to receive commission payments, 12b-1 fees, revenue sharing, marketing allowances and other variable forms of compensation. Unfortunately, BICE has missed the mark and, as currently proposed, would lead to the same unwanted consequence as the 2010 proposal – an effective ban on commission payments, 12b-1 fees, and other variable forms of compensation – by hugely increasing the burdens on financial advisors and financial institutions.

Problems with the Pre-Advice Contract:

BICE would require that both the financial advisor and the firm enter into a pre-advice, pre-point-of-sale contract with a potential investor. It is here that we encounter the first problem with BICE. As written, BICE would require a financial advisor to have a potential client sign a contract prior to any meaningful conversation about their financial situation in order to ensure they do not inadvertently offer retirement advice. As currently written, this contract would be presented to a potential client at a stage in the engagement process when I am not making any recommendation. At this early stage, I am just outlining the different things that the individual can do with his or her assets. I want to ensure that the individual fully understands all of the available options, feels comfortable with me as a person, and has some time to digest the information presented before I ever make a recommendation regarding how the individual should be

[17] Of all the IRAs in existence in year-end 2010, 99% of those with less than $10,000 in assets were held in commission-based accounts, over 90% with assets between $10,000 and $25,000 were in commission-based accounts, and over 80% with assets between $25,000 and $50,000 were in commission-based accounts. *See*, Oliver Wyman, *Assessment of the impact of the Department of Labor's proposed "fiduciary" definition rule on IRA consumers*, April 2011, *available at* https://www.dol.gov/ebsa/pdf/WymanStudy041211.pdf.

investing his or her retirement assets. Requiring me to put a contract in front of an individual I have just met and having to tell him or her that I cannot provide even basic information regarding retirement savings options is counterproductive. In my experience, individuals who are interviewing financial advisors would not be willing to sign a contract with a financial advisor they have just met and haven't decided to do business with yet. As a result, I believe this "pre-engagement" contract will create an unnecessary hurdle to individuals engaging financial advisors to help them prepare for retirement and other financial goals.

Problems with BICE's "Approved Assets" List:

Another requirement of the BICE is that in order to qualify for its protections, an advisor may only provide retirement advice regarding investments that are contained within BICE's list of approved investment options available to plans and IRAs.[18] Among the products that are not included in the list of approved investments are non-traded Real Estate Investment Trusts (non-traded REITs), and Business Development Companies (BDCs), and other non-exchange listed equity securities and commodities futures. By creating a limited universe of investments that an advisor can recommend with regards to retirement accounts, the DOL has taken a cookie-cutter approach that assumes that products excluded from the "approved list" would never be in the best interest of an investor.

Financial advisors are in the best position to work with their clients to understand their clients' unique retirement savings needs and recommend investments that best match the goals, risks, and circumstances of each individual investor. Furthermore, I not only help my clients save for their retirement, but I also advise them on the benefits of receiving some of their savings in the form of lifetime income. Individuals nearing retirement need to consider supplementing their Social Security with an additional level of guarantee, so that they won't outlive their savings. Unfortunately, this proposal has the impact of preventing me from advising those near retirees on the benefits of annuities and assisting them with product selection, putting that individual at risk of

[18] As per the proposal, the approved list of assets "includes only the following products: bank deposits, certificates of deposit (CDs), shares or interests in registered investment companies, bank collective funds, insurance company separate accounts, exchange-traded REITs, exchange-traded funds, corporate bonds offered pursuant to a registration statement under the Securities Act of 1933, agency debt securities as defined in FINRA Rule 6710(l) or its successor, U.S. Treasury securities as defined in FINRA Rule 6710(p) or its successor, insurance and annuity contracts, guaranteed investment contracts, and equity securities within the meaning of 17 CFR 230.405 that are exchange traded securities within the meaning of 17 CFR 242.600." The proposal also specifically excludes "any equity security that is a security future or a put, call, straddle, or other option or privilege of buying an equity security from or selling an equity security to another without being bound to do so."

running out of their savings in their older years when they can least afford it. The approach taken by the DOL in the BICE prevents advisors from having a full range of investments options and will prevent advisors from recommending products that very well may be in the best interest of an investor. Ultimately, these decisions are best made by investors working in collaboration with a financial advisor, not by officials at the DOL who don't understand the individual investor's needs.

Problems with the Mandated Point of Sale and Annual Disclosures:

Yet another concern with BICE comes in the form of its mandated disclosures. BICE requires that, prior to the execution of an asset purchase, an investor be provided an individualized chart that projects the total costs (in dollars) of the investment for one-, five-, and ten-year periods. In addition to this initial disclosure, BICE also requires that an annual disclosure be provided to the investor. The annual disclosure must list: (1) each asset purchased or sold during the previous year with the corresponding transaction price; (2) the total amount of fees and expenses with respect to each asset; and (3) the total amount of all direct and indirect compensation received by the advisor and the firm as a result of each asset.

The annual disclosure will increase compliance burdens on financial advisors. Financial advisors will have to ensure that their systems and reports are reprogrammed so that they capture the information being requested by the DOL. It will take a healthy amount of time and resources to ensure full compliance with such a disclosure. The same is true for the proposed initial disclosure, but the initial disclosure comes with an extra concern. In order to be able to provide an investor with the estimated costs (in dollars) of the investment for the one-, five-, and ten-year periods mandated by BICE, an advisor would have to make performance projections for the investment in order to make a projection of the costs. This very well could put advisors in direct conflict with SEC and FINRA rules that prohibit performance projections. Furthermore, such projections may create expectations by investors that their investments will achieve such performances, which could lead to hazardous and unreasonable investor expectations. Both the initial and annual disclosure requirements need to be reconsidered so that they provide investors with useful information in a concise manner that does not conflict with regulations already on the books.

Problems with Internet Disclosures:

Another problematic section of BICE revolves around the massive and overly-burdensome Internet disclosures. BICE requires that firms maintain a publically-accessible website that is updated on at least a quarterly basis. This website must be in machine-readable format, and include: (1) the direct and indirect compensation payable to the firm, each individual advisor, and each individual affiliate of the firm for each asset available within the last year; and (2) the source of any and all compensation and its variations among assets. It is clear to me that the DOL underestimates the complex nature of these disclosures. In the independent model, financial advisors have access to a wide variety of investment products which they offer to their clients. Each of these investment products has unique pricing structures and compensation models. For example, when factoring in the various share classes available, a single mutual fund family may offer 500 or more versions of their funds. As a result, compiling, presenting and maintaining the required Internet disclosure for each financial advisor affiliated with a financial institution will be a massive undertaking with significant costs to my clients. In addition, the scope, breadth and complexity of the project will lead to inadvertent errors which may confuse investors or expose financial advisors and financial institutions to unreasonable litigation.

Problems with Data Retention and Production Requirements:

Firms must also retain all records relating to BICE for six years and provide unconditional access to such records during normal business hours to DOL, the IRS, plan participants, and IRA owners (or their representatives). Furthermore, on request from DOL, a firm must produce massive amounts of information for each asset, by quarter, within six months of any data request. The data that may be requested includes the aggregate shares/units bought, the aggregate purchase price and investor costs of those purchases, the revenue received by the firm and its affiliates along with the identity of each revenue source, and comparable information for all sales and all holdings. Firms would also have to produce the following information with regards to their advisors: (1) the identity of each advisor; (2) quarterly return information for each advisor's clients' portfolios; and (3) external cash flows in and out of each portfolio by date. The proposal gives the DOL the right to publicly disclose any and all of the information obtained during the data requests without any identifiable financial information.

As can be seen from the above summary of the data retention and production request requirements, this will not be an easy task for the industry to undertake. I am no expert

regarding the logistical, technical, and financial resources that would be required in order to put the proper systems in place to manage these requirements, so I will leave that to others to expound upon. That being said, I have no doubt that this will be a huge undertaking that will come at great costs to the industry. These new compliance burdens will come with astronomical costs that will inevitably be passed down to financial advisors and impact the consumer. For BICE to be a workable exemption, these requirements must be greatly scaled back so that the costs of compliance are reasonable.

Problems with "Levelizing" Compensation:

BICE requires the advisor to avoid recommending an asset if the total compensation would exceed "reasonable" compensation for the total services provided. The DOL provides very little information regarding what would be considered "reasonable" compensation and what types of variable compensation models would meet the requirements of BICE.

The DOL does discuss the need for firms to go through a rigorous process of proving that a variable compensation model meets the requirements set forth in BICE and also states that compensation models based on flat fees would meet the requirements. The combination of these two factors serves as a quasi-endorsement of level compensation models, and will likely push firms in the direction of "levelizing" compensation models. As the compensation models become "levelized," I believe they will no longer be reflective of the services that I and other financial advisors provide. This will likely have the effect of financial advisors instituting, or raising, account minimums on retirement accounts, thus making it more difficult for investors of moderate means to gain access to valuable retirement advice and products. I do not want to be in a position where I have to turn away a potential client who needs my advice because his or her account would cause my business to incur losses, but the DOL proposal's push towards "levelized" compensation would have that consequence for my practice and the individuals I serve.

Problems with a New Private Right of Action:

The last concern with BICE that I will cover is its creation of a new private right of action that was never authorized by ERISA or any other related statute. This new private right of action would stem from the contract that a financial advisor and a firm have to enter into with a client. BICE prohibits the inclusion of a provision disclaiming liability from a violation of any contractual term or any waiver or qualification of the investor's ability to enter into a class action suit against

the advisor or the firm for any violation of the contract's terms. That being said, the contract may allow for arbitration of individual investor claims.

In creating this new private right of action, the DOL has failed to recognize that ours is an industry that is already heavily regulated and has an extremely low incidence of unethical behavior. Out of the over 637,000 individuals regulated by FINRA in 2014, approximately 0.2% had disciplinary actions filed against them.[19] This is largely attributable to the fact that, as I stated earlier, a financial advisor's business is built on trust and reputation. If we break that trust with our clients, then we are out of business. It's that simple.

Beyond the basic principles of trust and ethical conduct to which I and virtually every other advisor adhere, there are already effective federal and state remedies that are available to consumers who feel that they have been harmed by a broker-dealer and other advisors, including the FINRA arbitration and mediation processes. Because of the effective set of remedies already in place to help potentially aggrieved investors, the new private right of action created by BICE is wholly unnecessary. Perhaps the biggest impact of this private right of action will be an increase in error and omission insurance premiums. These increased costs will be borne by financial advisors and ultimately impact the consumer. This may further establish retirement advice as cost prohibitive for investors of modest means. Furthermore, because of the complexities of the proposal, it is conceivable that firms and advisors will make inadvertent errors that do not materially harm consumers, but give rise to suits against firms and advisors. All of this will be a boon to lawyers, while harming investors and small businesses across the country. Therefore, any final rule should do away with the proposed private right of action, thus allowing the current effective network of federal and state remedies to handle alleged instances of misconduct.

Even though each of the above requirements of BICE presents problems, the biggest concern is the cumulative effect of all of these issues. If the DOL moves forward with a largely unchanged rule, financial advisors will be faced with a mountain of regulatory burdens to overcome. This will place serious financial, compliance, liability and administrative strains on the many small businesses across this country run by financial advisors. Unfortunately, the costs associated with implementation will also be felt by the clients that we serve and it may lead many to not seek or be able to afford critical retirement advice. Because of this, it is absolutely vital

[19] http://www.finra.org/newsroom/statistics.

that the DOL make substantial changes to its proposal to ensure that there is a workable path forward for all parties.

There are Better and Less Disruptive Alternatives to the DOL's Proposal

While FSI is committed to working constructively with the DOL to improve the current proposal, we believe there are better ways to achieve the goals of investor protection that guide the DOL in this effort, and guide our industry and the various federal and state regulatory entities that supervise our industry.

As I stated earlier in this testimony, FSI strongly supports a carefully-crafted, uniform fiduciary standard of care applicable to all professionals providing personalized investment advice to retail clients. The idea of a uniform fiduciary standard of care is not an idea that is solely championed by FSI. Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Section 913) instructed the SEC to evaluate the effectiveness of existing standards of care for financial advisors. The SEC is specifically charged with evaluating how the current standards of care affect the ability of advisors to provide personalized investment advice to retail customers, and identify any places for improvement in these standards. In order to accomplish this mission, Section 913 gave the SEC the authority to adopt a uniform fiduciary standard of conduct for financial advisors. Earlier this year, SEC Chair Mary Jo White announced her support for SEC rulemaking adopting a uniform fiduciary duty of care.[20] FSI has a strong preference for the SEC to take the lead or, in the alternative, conduct a joint rulemaking with the DOL so as to reduce inconsistent standards that would likely create compliance burdens for advisors and increase costs for investors.

Beyond the uniform fiduciary standard of care, improved disclosures would address many of DOL's concerns that have led to the proposal. Investors can make better choices when they are properly informed of the differences between the advice and services being offered. In order to provide investors with the information that they need, investors should receive concise, consolidated disclosure documents written in plain English. This course of action is beneficial on three fronts. First, it helps to increase the knowledge base of investors because they are able to

[20] See, Lynch, Sarah, *White says SEC should act on fiduciary rule for brokers, advisers*, Reuters, *available at* http://www.reuters.com/article/2015/03/17/sec-fiduciary-white-idUSL2N0WJ1E920150317.

better understand information related to their retirement savings. Investors would have access to important information in language that is easy to understand and not full of "legalese." Second, improved disclosures would not upend the retirement savings landscape. It would require that disclosures be rewritten, but, unlike DOL's current proposal, it would not entail the financial services industry completely overhauling business models in order to achieve compliance. Third, and most importantly, this course of action would preserve access to retirement advice, products, and services for small- and mid-sized investors.

As a way to illustrate how reworked disclosures could work and start a conversation regarding this approach, FSI suggests the following two-tiered approach that would be beneficial to investors:

1) A short-form document focused on the issues that are of greatest importance to investors provided at the point of engagement.[21] The document would include:
    - The standard of care owed by the financial institution and financial advisor to each client;
    - The nature and scope of the business relationship between the parties, the services to be provided, and the duration of the engagement;
    - A general description of any material conflicts of interest that may exist between the financial institution, the financial advisor and the investor;
    - An explanation of the investor's obligation to provide the financial institution and financial advisor with information regarding the investor's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose;
    - An explanation of the investor's obligation to inform the financial institution or financial advisor of any changes in the above information;
    - A phone number and/or e-mail address the investor can use to contact the financial institution regarding any concerns about the advice or service they have received; and

[21] The disclosure could be provided in paper or electronic format.

- A description of the means by which a customer can obtain more detailed information regarding these issues free of charge.

2) An expanded disclosure that would provide investors with access to full details via the financial institution's website or brochures to be provided free of cost. The short-form disclosure form above would have information on how to access this expanded disclosure. Utilizing hyperlinks and other internet functionality, investors would be able to access the following information in areas where they desire additional detail:
    - A detailed schedule of typical fees and service charges;
    - The specific details of all arrangements in which the firm receives an economic benefit for providing a particular product, investment strategy, or service to a customer; and
    - Other information necessary to disclose material conflicts of interest.

This is just one alternative to the current DOL proposal that could achieve the DOL's goals. There may be other, better alternatives out there that should be discussed and analyzed. Both FSI and I are ready and willing to engage in the development of disclosures, standards of care, or other mechanisms that would effectively protect investors and preserve access to retirement advice and products for all investors.

Conclusion

I thank Chairman Roe, Ranking Member Polis, and the rest of the Subcommittee for allowing me to share my thoughts on this very important issue. Should the Subcommittee need anything further from FSI or from me, we would be glad to provide the requested information.

FSI and I want to ensure that Americans are well-prepared to make decisions regarding their retirement savings. This will require that our retirement savings landscape continue to evolve so that it is easier for investors to receive high-quality, individualized investment advice from a trusted advisor. As a result, we support the adoption of a carefully-crafted, uniform fiduciary standard of care applicable to all professionals providing personalized investment advice to retail clients. Unfortunately, while well-intentioned, the current DOL proposal will make it harder for all Americans to receive such retirement advice. This is because it is based on flawed assumptions that lead it to be too complex, too cumbersome, and too costly, thus resulting in a

proposal that will leave small- and mid-sized investors without affordable access to much-needed retirement advice and products. FSI believes that there are alternatives to the current DOL proposal, including a uniform fiduciary standard and better, more concise disclosures. We stand ready to continue our engagement with the DOL and any other interested parties to try and develop a final rule or other proposal that will protect investors and ensure that all Americans have access to the retirement advice, products, and services that will help them achieve the dignified retirement that they deserve.

About Dean Harman, CFP ®

Dean Harman, CFP ® has been practicing in the financial services industry since 1994. He operates Harman Wealth Management, LLC in The Woodlands, Texas. Harman Wealth Management, LLC specializes in working with clients who are business owners, executives and sports coaches.

In 2006 Dean purchased Estate Resources, a financial planning, RIA and asset management firm in Houston, Texas, which he merged into Harman Wealth Management, LLC In 2010 he purchased ETF Plan, Inc., and asset management, RIA firm which also merged into Harman Wealth Management, LLC He serves on the Advisory Boards of Genworth Financial, Sagepoint Financial, The Financial Services Institute, and The College of Business and Behavioral Sciences at Clemson University.

Dean is regularly quoted in the media and has been featured in: The Wall Street Journal, the New York Times, Newsweek, Kiplinger's, Smart Money, CBS Market Watch, Men's Health, Yahoo Finance, Google Financial News, Retire Smart, The Players Club, The Journal of Financial Planning, Investment News, Investment Advisor, H-Texas and local media. He also had an appearance in the movie Tin Cup.

He is a graduate of Clemson University where he played football from 1987-1991. Following college he had a brief stint with the Tampa Bay Buccaneers in 1992 and 1993 before starting his career in financial planning.

Background on Independent Broker-Dealers, Independent Financial Advisors and FSI

For more than 40 years, independent broker-dealers and independent financial advisors have brought Wall Street to Main Street, offering comprehensive financial planning services and unbiased, affordable investment advice to millions of individuals, families and businesses large and small. The approximately 167,000 independent financial advisors make up nearly 60% of all practicing financial advisors nationwide, offering services that include financial education, planning, implementation and investment monitoring. While we serve a broad cross-section of clients, our members' typical clients are middle class, Main Street investors – those investing tens or hundreds of thousands of dollars, not millions.

Independent broker-dealers and independent financial advisors also share a number of other business characteristics. They generally clear their securities business on a fully disclosed basis; primarily engage in the sale of packaged products, such as mutual funds and variable insurance products; take a comprehensive approach to their clients' financial goals and objectives; and provide investment advisory services through either affiliated registered investment adviser firms or such firms owned by their registered representatives. The independent business model allows our members to tailor their products and services to support both the small investors opening their first IRAs and the more affluent clients who need more complex wealth management services.

These financial advisors operate as self-employed independent contractors, not as employees of their affiliated broker-dealer firms. They are small business owners with strong ties to their communities. In fact, their standing in their communities is critical to their success, as word-of-mouth and reputation are their primary sources of new clients. Independent financial advisors generally meet their clients in person and provide their services face-to-face or over the telephone, forming personal, trust-based relationships. Thus, independent financial advisors have a powerful incentive to pursue their clients' investment goals with integrity and transparency, and every reason to want to make sure their clients receive personalized investment advice that is in their best interest.

Since 2004, the Financial Services Institute (FSI) has represented the interests of independent financial service firms and independent financial advisors. Through FSI, these financial professionals work together to promote the independent business model and a regulatory environment that serves all its constituents effectively.

Independent broker-dealers and independent financial advisors formed the Financial Services Institute not only to serve as an advocacy organization, but also to be a forum for improving compliance efforts and promoting our business model. FSI is committed to preserving the crucial role of independent broker-dealers and independent financial advisors in helping Main Street Americans plan for their futures and meet their long-term financial goals. As part of this mission, FSI conducts industry surveys and research, and provides a forum for members to share their best practices in compliance, operations, and marketing. FSI also serves as an advocate in Washington, using the information it collects to help shape a regulatory environment that is fair and balanced and serves all its constituents.