Consumer Federation of America

Statement for the Record of Micah Hauptman, Director of Investor Protection
Consumer Federation of America[1]

Hearing on the DOL Retirement Security Proposal
House Education and Workforce Committee
Subcommittee on Health, Employment, Labor, and Pensions
Scheduled for February 15, 2024

Dear Chairman Good, Ranking Member DeSaulnier, and distinguished Members of the Subcommittee,

Consumer Federation of America (CFA) strongly supports the Department of Labor's (DOL's) Retirement Security Proposal. This rulemaking is necessary for the protection of retirement savers.

As we all know, retirement investing can be complicated, and many retirement savers turn to financial professionals for investment advice. Retirement savers reasonably expect and believe the financial experts they turn to will act in their best interests, and retirement savers trust and rely on the investment advice they receive. Retirement savers' beliefs and expectations about the relationships they are in and the services they receive isn't misplaced. It's because everything financial professionals and their firms do is designed to send the message that they are in relationships of trust and confidence with investors and they provide advice in investors' best interests that should be relied upon. From the titles they use, to how they describe their services and relationships, to how they function, any reasonable person would view these as trusted advice relationships.

No retirement saver would support being steered to overpriced, suboptimal products or services that aren't in their best interest by financial professionals who seek to evade their regulatory obligations and accountability, all so they can get a big payday.

Unfortunately, that's what the 1975 five-part test defining fiduciary investment advice allows. It allows financial professionals to function as advice providers, to occupy positions of trust and confidence with retirement savers, and to foster reliance on the advice they provide, while evading the fiduciary duty appropriate to their advisory role. The five-part test is inconsistent

[1] CFA is a non-profit association of more than 250 national, state, and local pro-consumer organizations. It was formed in 1968 to represent the consumer interest through research, advocacy and education.

with the text of ERISA and it defeats retirement savers' reasonable expectations about the relationships they are in and the services they are receiving.

The proposed redefinition of fiduciary investment advice, on the other hand, is faithful to the statute and would honor retirement savers' reasonable expectations when receiving advice from financial professionals who hold themselves out and function as trusted advice providers. It would appropriately cover rollover recommendations, plan advice, and advice about non-securities, ensuring that regardless of the type of financial professional a retirement saver works with or the type of product the professional recommends, their advice would be subject to a strong best interest framework that ensures conflicts of interest do not taint their advice.

Other Regulators Have Not Fully Addressed the Problem of Conflicted Retirement Advice.

First, the SEC has not fully solved the problem. While the Securities and Exchange Commission (SEC) finalized Regulation Best Interest (Reg. BI) in 2019 to enhance the standard of conduct for broker-dealers, this standard does not apply to all financial professionals, all products, or all accounts. Specifically, Reg. BI is limited to recommendations to retail customers about securities. Thus, to the extent a financial professional provides recommendations about non-securities, such as some insurance products, bank products, real estate, commodities, or cryptocurrencies, Reg. BI simply doesn't apply. Similarly, to the extent a financial professional provides recommendations to retirement plans, which do not meet Reg. BI's definition of retail customer, Reg. BI doesn't apply. As a result, there is a lack of uniform protections for retirement savers, which leaves them vulnerable to harmful conflicts of interest.

Second, the NAIC Model Rule for annuities provides weak protections. While the National Association of Insurance Commissioners (NAIC) adopted updates to its Annuity Transactions Model Regulation (#275) in 2020, it is a best interest in name only standard. Unlike Reg. BI, which imposes an explicit best interest obligation on broker-dealers, the NAIC Model Rule states that an insurance producer "has met" their best interest obligation if they "have a reasonable basis to believe the recommended option effectively addresses the consumer's financial situation, insurance needs, and financial objectives." This "effectively addresses" standard is a lower standard than the one Reg. BI places on broker-dealers and is largely a restatement of the previous annuity suitability rule.

In addition, unlike Reg. BI, which defines "material conflict of interest" broadly to include all forms of compensation and requires firms to mitigate conflicts of interest that create incentives for financial professionals to place their or their firm's interest ahead of the retail customer's interest, the NAIC Model Rule remarkably excludes both cash and non-cash compensation from its definition of "material conflict of interest." As a result, the NAIC Model Rule does not require financial professionals recommending annuities to mitigate their compensation-related conflicts. This fractured regulatory environment has created uneven protections for retirement savers and loopholes in the regulation of annuities, where annuities that are regulated as securities are subject to Reg. BI while annuities that are not regulated as securities are subject to the weaker NAIC Model Rule.

<u>This Proposal is Substantially Different From the 2016 Rule and is Responsive to the 5th Circuit Court of Appeals' Concerns</u>.

This proposal defines fiduciary retirement investment advice much more narrowly than the 2016 rule. According to the 5th Circuit Court of Appeals, the 2016 fiduciary rule was overbroad in defining who was an investment advice fiduciary because it captured certain interactions where an investor might not have placed their trust and confidence in the financial professional. In response to these concerns, the proposal provides that fiduciary status would attach only if compensated recommendations are made in certain specified contexts where a retirement saver can and should reasonably place their trust and confidence in the advice provider.

In addition, this proposal does not require firms to execute contracts warranting compliance. The 2016 fiduciary rule required firms to execute best interest contracts with warranties guaranteeing that they and their financial professionals would comply with certain protective conditions. The contract created an enforcement mechanism for harmed IRA investors, allowing them to sue for a firm's breach of the warranties. Because the 5th Circuit held that the DOL was prohibited from creating this private right of action, the new proposal neither includes a contract requirement nor requires firms to warrant that they will comply with certain protective conditions. The only enforcement mechanism for violating the rule with regard to IRA investment recommendations, consistent with already-existing law, is an IRS imposition of an excise tax.

<u>Industry Opponents' Arguments Against the Rule are Groundless.</u>

Some industry opponents have argued that small savers, those with low account balances or of modest means, would lose access to investment advice under this rule and would be worse off. This is an industry scare tactic that has no basis in fact. Many financial professionals support a strong fiduciary standard and operate under it very successfully, while serving clients all along the income spectrum. If some firms were to decide to pull out of the market, others would step in to provide high quality products and services without harmful conflicts.

Small savers are especially vulnerable to the detrimental effects of conflicted advice. With fewer economic resources, small savers can least afford to lose any of their retirement savings due to harmful conflicts of interest. Small savers have the most to gain from receiving high quality advice that serves their best interest rather than the interests of financial professionals or their firms.

Also, as discussed above, to the extent any industry claims about a potential loss of access to advice are based on industry opponents' assumptions about the 2016 rulemaking, that rule was substantially different from the current rulemaking. As a result, any comparisons to the 2016 rule are not applicable to the current proposal. We also urge members of Congress to be skeptical of any "evidence" against the rule that industry opponents repackage from 2016. Most of what they have offered are biased industry surveys based on opaque, non-verifiable information.

In addition, the proposal broadly aligns with the SEC's Reg. BI. We are not aware of any evidence that Reg. BI has reduced small savers' access to investment recommendations from broker-dealers. Just the opposite, Reg. BI showed that financial professionals and firms can be subject to an explicit best interest standard that requires conflicts of interest to be mitigated, while still allowing financial professionals to be paid by commission. We expect the

Department's rule and exemptions to operate similarly, aligning and extending these protections to retirement plans and their participants and to retirement savers who invest in non-securities.

Finally, to the extent industry claims about a loss of access to advice are made by the same groups who challenged the 2016 rule, it's important to note that these groups claimed in court that they don't provide advice, they provide arms-length sales recommendations like car dealers. While we strongly disagree with that assertion, these are mutually inconsistent arguments. Also, if one were to accept their legal argument, then retirement savers wouldn't lose access to advice, they'd lose access to self-interested sales pitches deceptively disguised as advice.

In conclusion, this is an important regulatory initiative that it deserves strong support.

Thank you,

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