Consumer Federation of America

Statement of
Barbara Roper, Director of Investor Protection
Consumer Federation of America
before the
U.S. Department of Labor
on
Improving Investment Advice for Workers and Retirees
September 3, 2020

Good afternoon. I am Barbara Roper, Director of Investor Protection for the Consumer Federation of America. I appreciate the opportunity to testify today on the Department's advice rule.

Since the comment period closed, I have had a chance to review the comments filed by broker-dealer and insurance firms and their lobbyists in response to the proposal. I have to admit it was a dispiriting exercise. And I was particularly taken aback by the cynical claim, repeated here today, that the Preamble's explanation of how the reinstated definition of fiduciary investment advice would apply to rollover recommendations would somehow "effectively reinstate the invalidated 2016 fiduciary definition," just because the Department indicated it might not always interpret the definition's five-part test exactly as it had in the past.

The Department was wrong, in our view, to reinstate the five-part test, which it has previously found enables firms to evade their fiduciary obligations in circumstances where they are clearly functioning as advice fiduciaries and are reasonably relied on as advice fiduciaries by retirement savers. The amount of comment the Department has received on this point demonstrates just how unwise it was to reinstate the definition through a final rule, with no opportunity for input.

But it is patently absurd to suggest that what the Department did closely resembles the 2016 rule. On the contrary, having made the case for why rollover recommendations *should* be held to a fiduciary standard – their importance to retirement savers' financial well-being, the incentives firms have to recommend inappropriate rollovers – the Department only modestly expanded the portion of rollovers that will be covered by the definition, and left many of the most problematic rollovers outside the definition.

Saying that rollovers in the context of an ongoing relationship constitute fiduciary investment advice is a small step in the right direction, but it is a far cry from unequivocally covering all rollovers in the definition, as the 2016 rule would have done. Similarly, saying that firms may need to do more than stick a disclaimer in 6-point type in a disclosure document to avoid any fiduciary obligations is appropriate, as far as it goes, but it would still appear to leave firms plenty of room to come up with a way to avoid those obligations, even in circumstances when the retirement saver will rely on those recommendations as a primary basis for their investment decision.

What comes through loud and clear from these industry comment letters is that broker-dealers and insurers will be satisfied with nothing less than a full return to the bad old days when, as was documented at the time, firms could recommend rollovers without any regard to the best interests of the retirement saver and all too often did just that, costing retirement savers billions in lost savings.

But, even if we are wrong, and the Preamble interpretation *would* have the effect predicted by industry of causing vastly more rollover recommendations to be considered fiduciary investment advice under ERISA, it would still not have the effect these industry groups claim. It would not, for example, cause simple sales recommendations to be held to a fiduciary standard.

On the contrary, under the Department's proposed new class exemption, fiduciary investment advice would be held to non-fiduciary sales standards modeled, with only minor differences, on the SEC's Regulation Best Interest for broker-dealers and the NAIC's model rule for annuities sales. These are standards that these same industry groups strongly support when applied to non-retirement accounts, so it is difficult to understand their predictions of dire consequences if these same industry-friendly sales standards are applied to advice regarding rollovers.

Since the Department issued its proposal one day before the SEC's Reg. BI was due to take effect, and the comment period closed when that new rule had been in effect for just over a month, there hasn't been time for us – or the Department – to comprehensively study whether, or to what extent, Reg. BI has caused firms to change the way they do business. In particular, there hasn't been time to fully assess whether Reg. BI has caused firms to abandon incentive practices that the Department has previously determined, as part of the regulatory record for this proposal, are likely to induce financial professionals to base their recommendations on their own interests, rather than their customers' best interests. We have even less information regarding the effect of the NAIC model rule.

To the extent possible within the rushed timeframe for this rulemaking, however, we have begun a review of the disclosures firms provide under Reg. BI in which they describe their conflicts of interest and compensation practices. The first thing I can report, based on that review, is that even the best of these disclosures are likely to be of little value to the typical, financially unsophisticated retirement saver. The worst of these documents are dense and unreadable and full of boilerplate, and we've seen far more bad examples than good.

Now, we also have the Wall Street Journal reporting that the new Customer Relationship Summaries brokers and investment advisers are required to provide may be inaccurate. Specifically, at least 1,300 firms appear to falsely claim to have no disciplinary record, when in fact they or their reps have a history of customer complaints, regulatory actions against them, or even criminal conduct. And 80 firms failed to answer the question at all. If firms are getting something this basic wrong – or if they are deliberately misleading investors – what does that tell us about the quality of their compliance programs or the value of these disclosures in protecting investors?

Because the Department relies on these Reg. BI and Advisers Act disclosures to satisfy compliance with its own proposed exemption, it has an obligation to review them carefully to determine whether they will in fact lead to informed investment decision-making. The inescapable conclusion from an honest review of the documents is that they will not.

The other thing that begins to emerge, if you dig into the details of these disclosures (and you will have to dig), is that little seems to have changed in brokerage firms' conflicts of interest and compensation practices since Reg. BI was adopted. For example, the SEC made headlines by banning time-limited, product-specific sales contests that never really existed at brokerage firms. But it did nothing to address production-based contests and incentives of the type that have been associated with inappropriate rollover recommendations. A review of large retail brokerage firms' Reg. BI disclosures makes clear that production-based incentives remain commonplace.

Meanwhile, the conflict that has been shown over the years to be most responsible for abusive sales practices – the heightened remuneration brokers can receive selling complex, opaque investments, such as most types of annuities, non-traded REITs, and private securities – remains unaddressed. Other problem areas previously identified by the Department, such as certain types of recruitment incentives, ratcheted payout grids, and third-party compensation from product sponsors can all be found, to a greater or lesser degree, among the large retail firms whose disclosures we have reviewed.

It is virtually impossible to ascertain from most of these disclosures what, if anything, the firms are doing to "mitigate" these conflicts. A few firms make boilerplate statements about addressing conflicts through a combination of training, supervision, and disclosure. But there is no evidence in the disclosures we've reviewed of meaningful changes to reduce widespread, harmful incentives, certainly nothing on the order of magnitude needed to reassure retirement savers that their interests are likely to come first.

We do not pretend to have conducted a comprehensive review of industry compensation practices and conflicts of interest since Reg. BI was implemented. In the rushed process the Department has adopted for this rulemaking, there simply hasn't been time – for us or the Department – to do so. Only the firms themselves are in a position to tell us whether, or to what extent, they have altered their incentive systems since Reg. BI was implemented. Any such evidence is notably absent from the comment letters brokers and insurers submitted in response to this rulemaking. If industry had a positive story to tell in that regard, presumably they would have told it. Their silence is deafening.

In conclusion, there is simply no evidence to support a finding that Reg. BI or the NAIC model rule will adequately protect retirement savers, and the evidence that does exist leads to the opposite conclusion. The Department therefore cannot reasonably move forward with this rulemaking based on the evidence before it.

The Consumer Federation of America is an association of more than 250 nonprofit consumer organizations that was established in 1968 to advance the consumer interest through research, advocacy, and education.