AARP

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Office of Regulation and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, D.C. 20210

Attention: Class Exemption for the Provision of Investment Advice and Investment Advice Regulation

To Whom It May Concern:

AARP appreciates the opportunity to comment on the Department of Labor's (DOL or Department) proposed regulation and Class Exemption concerning Investment Advice.[1]

AARP shares the goal of increasing access to investment advice for individual account plan participants. To that end, we have consistently asserted that such advice must be subject to the Employee Retirement Income Security Act's (ERISA) fiduciary rules, based on sound investment principles and protected from conflicts of interest.

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[1] With 40 million members, AARP is the largest, nonprofit, nonpartisan organization representing the interests of Americans age 50 and older and their families. Nearly half of our members are employed full- or part-time. AARP helps people age 50+ achieve independence, choice and control in ways that are beneficial and affordable to them and society as a whole. A major priority for AARP is to assist Americans in accumulating and effectively managing adequate retirement assets. The shift away from defined pension plans to defined contribution plans places significant responsibility on individuals to make appropriate investment choices so that they have adequate income to fund their retirement years. Therefore, AARP has a strong interest in promoting the requirement of high quality, conflict-free, effective and timely investment advice.

Although the Pension Protection Act (PPA) permits conflicted fiduciary investment advisors, Section 601 of PPA, Congress did not intend for their advice to be given to participants and received without restrictions or participant protections. We believe that the proposed regulation and the Class Exemption go far beyond the intent of Congress and the carefully crafted compromised between the House and the Senate. *E.g.*, Recorded Vote 328, 109th Congress, November 16, 2005. And contrary to the statute's mandate, AARP submits that the proposed regulation and Class Exemption provide inadequate restrictions on the provision of conflicted investment advice. More significantly, neither the proposed regulation nor the Class Exemption provide the necessary substantive protections for participants and beneficiaries. AARP urges the Department to rescind the proposed regulation and Class Exemption, and to revise them so as to expand the protections for participants and beneficiaries in accordance with ERISA's purpose and the intent of Congress.

Background

As a result of the growth of 401(k) and other individually directed account plans, more individuals than ever before are responsible for investment decisions that will ultimately determine the extent to which they have accumulated the savings necessary to ensure an adequate level of retirement benefits. Unfortunately, many individuals are simply not prepared to handle this investment responsibility and risk. Many participants have little experience in, or understanding of, investment fundamentals. Compounding the lack of skills and preparation for the task is the fact that too few individuals have the time and/or the knowledge to work through the mountain of financial information available today. Moreover, plan participants find it difficult to cope with the sophisticated marketing strategies of the financial institutions that offer conflicting and confusing information to unsophisticated investors.

Currently, many plans provide investment education to plan participants, including asset allocation examples, to inform them of available investment strategies in general and under their particular plan. Too often, however, this information has proven to be insufficient and too complex for many participants. To address this problem, many plans now make available independent investment advice to plan participants.

In connection with plan efforts to give participants access to investment advice, AARP has consistently believed that two important goals are necessary. First, the adviser should be qualified to provide investment advice to the plan participants. Equally as important, the adviser should be independent – that is, free from financial conflict. ERISA has long recognized that financial conflict gives rise to divided loyalties and thus poses the risk that the investment advice will <u>not</u> be based on the sole interest of the participant. Section 404 of ERISA, 29 U.S.C. § 1104. Investment advisers that stand to benefit financially from the advice they dispense face such a conflict. Encouraging independent, unbiased investment advice is likely to promote participants' long-term retirement security while minimizing the potential for employee dissatisfaction, plan entanglements in legal conflicts and litigation.

Studies of the financial services industry itself have found, for example, that broker conflicts have tainted the advice rendered to and received by individuals, that audit conflicts have undercut the value of audits of financial firms, and that analysts' reports have shown significant evidence of bias in company ratings. Allegations of conflict of interest were the basis for the historic settlement announced by the Chairman of the Securities and Exchange Commission and the Attorney General of New York on April 28, 2003. Ten of the nation's top investment firms reached an agreement with federal and state officials to settle enforcement actions that alleged:

> …all of the firms engaged in acts and practices that created or maintained inappropriate influence by investment banking over research analysts, thereby imposing conflicts of interest on research analysts that the firms failed to manage in an adequate or appropriate manner.

Moreover, the current financial crisis shows the problems that may occur when there are conflicts of interest and there is not conspicuous and complete transparency. These are the very types of problems that ERISA was designed to protect against.

The issue of the provision of investment advice to participants was the subject of hearings and extensive debate in Congress and public policy circles for an extended period of time that spanned three separate Congresses. Against this background, the PPA created a prohibited transaction exemption to permit plan fiduciaries to structure investment advice arrangements where the advice provider is affiliated with the provider of the underlying investment options. The statutory prohibited transaction permits one of two models. First, a compensation model may meet the exemption if the compensation received by the provider of advice does not vary based on the investment option selected. Second, a computer driven model may meet the exemption if the model uses generally accepted investment theories and is certified by an independent expert. Finally, the PPA offers plan sponsors protection from fiduciary liability for the advice given under these programs. The PPA confirms that the plan sponsor's liability is limited to the selection and monitoring of the entity providing the advice.

Trust in Financial Advisors

With the current turmoil in the financial markets, the not-so-distant corporate malfeasance at Enron, WorldCom and other companies, as well as mutual fund scandals, trust in the financial markets and the people who provide investment advice is at all time low. *Cf. 2008 Retirement Confidence Survey*, EBRI ISSUE BRIEF NO. 316 (April 2008) (finding retirement worries were growing before the most recent September 2008 crisis). Recent AARP surveys show that employees are reducing their contributions to their 401(k) plans, taking money out of their 401(k) plans and moving their money to lower risk investments**.** AARP, *The Economic Slowdown's Impact on Middle-Aged and Older Americans* at pp. 3, 6 (May 2008). Moreover, one survey raised the question of whether investment advice would do much of anything to improve individuals' retirement security. *2007 Retirement Confidence Survey*, EBRI ISSUE BRIEF NO. 304 (April 2007) (finding that although half of workers indicate that they would take advantage of professional investment advice, 2/3 would implement only some of the recommendations and 10% said they would implement none).
In order to regain the trust of participants, the proposed regulation and Class Exemptions should substantially reduce these conflicts of interest as much as possible and establish substantial participant protections.

Participant Protections

The proposed regulation and Class Exemption should be rescinded because they are in direct conflict with ERISA's overarching goal of protecting participants and beneficiaries.

Because plan participants are captive to the investment advisers the employer or other plan fiduciaries chosen to provide investment advice to them, participant protections must be stringent. The regulation does not do enough to protect participants and what may be for many their only retirement savings. The additional protections AARP sets forth below are the minimum protections that should be established for participants.

Investment Fees

Conflicted advisers may only provide conflicted advice if the employer or plan is paying all of the costs. If the participant is paying any portion of the fee, conflicted advice should not be permitted.

AARP disagrees with the Department's interpretation of "fee-leveling." This example illustrates the problem with the Department's interpretation.

> MONEY Funds has an affiliate, MONEY Advisers. MONEY Advisers provides investment advice to participants about which

MONEY Funds under a retirement plan a participant should invest in. An employee of MONEY Funds advises participant A in plan C to invest her account in the three funds (out of the 10 funds available) with the highest expense ratio, but whose historical performance is in the bottom half among the 10 funds available. Although MONEY Advisers and its employee do not receive any additional fees for this advice, MONEY Funds does receive additional fees because of the higher expense ratio.

AARP submits that this scenario violates the intent of Congress in requiring fee-leveling.

Moreover, the Class Exemption takes this scenario further and would permit MONEY Advisers (in the example) to receive higher fees. This is not the meaning of fee-leveling fees within the intent of Congress. Neither the funds nor any affiliate should receive additional fees for its investment advice. AARP strongly disagrees with the Department's assessment that the proposed regulation and Class Exemption sufficiently protects individual participants. AARP submits that the Department should rescind the proposed regulation and Class Exemption so as to interpret fee-leveling in a manner that truly protects participants.

Conflict Disclosure

Timely disclosure of the adviser's conflict should be provided every single time the adviser and a participant has contact. The proposed regulation and Class Exemption should require that this disclosure be bolded, highlighted and in larger typeface than the remainder of the disclosure. There should be an acknowledgement, in writing, that the participant is aware of and consents to the transaction, notwithstanding the conflict of interest.

Disclosure Form

As shown in AARP's last survey concerning fee disclosure, *Comparison of 401(k) Participants' Understanding of Model Fee Disclosure Forms Developed by Department of Labor and AARP* (September 2008),[2] the manner in which investment information is presented is of paramount importance in determining whether participants are able to use and understand the information. For example, both the DOL and AARP form included information directing the reader how to find additional information; however a significant percentage of people surveyed who reviewed the Department's form did not believe that this

[2] *Available at* http://www.aarp.org/research/financial/ira/fee_disclosure.html.

information was on the form. If confusion can arise absent design, then it should be apparent that information can be easily obfuscated so it is of little significance to participants.

The disclosure should include the incentives and/or fees the adviser or the company receives if the adviser's company keeps the account when the employee leaves the employer (*i.e*., maintaining the rollover account) or if the adviser obtains additional fees for investments of the participants outside of the plan.

The required disclosure should be made by paper unless the participant has affirmatively chosen to receive information electronically. See AARP's Comments to the DOL on Fee Disclosure, Section VII.C. Electronic and Paper Disclosures citing individuals' overwhelming preference to have information delivered in hard copy.

Model-Driven Advice

AARP generally supports the regulation regarding the requirements to meet the computer model-driven advice exception. In particular, if the retirement plan permits the use of employer stock as an investment option or match, there should be some specific rules when investment advice is given to participants on the subject of the employer's stock. First, the investment adviser should inform the participant about diversification and the reasons for its importance.[3] Second, in furtherance of diversification, computer models should be required to exclude employer securities in the asset allocation. Indeed, it is our understanding that most pre-PPA computer programs did not include employer stock as a separate asset class. If the participant implements the computer-recommended asset allocation model, the model would reduce or eliminate any allocation to employer stock as a separate asset class. Alternatively, the participant might elect to keep the employer securities and use the asset allocation model for the rest of the portfolio.

However, we note that the PPA contemplated that the computer model would do more than just provide "context" for the individualized advice. Indeed, the computer model was seen as an objective source of independent analysis that could be easily evaluated by regulators. The same cannot be said for oral individualized advice. Treating the computer model as merely providing "context" gives the investment adviser permission to simply move on from the computer model results. This was not the intent of Congress in crafting this exemption. Given the concern that participants cannot properly evaluate investment options, there is nothing in the proposed regulation or Class Exemption that indicates

[3] We note that even employee of financial firms such as Lehman Bros. and Smith Barney, who should know better, relied too heavily on employer stock and failed to diversify. Jason Zweig, *Wall Street Lays Egg With Its Nest Eggs*, WALL STREET JOURNAL (Sept. 27, 2008), *available at* http://online.wsj.com/article/SB122246399496280083.html.

participants would do any better at assessing and evaluating the individualized advice.

Investment Advice

Investment advisers should be required to render an estimate of retirement savings needs with participants. A recent study showed that fewer than 35% of investment advisers made such an estimate with their clients. *2008 Retirement Confidence Survey*, EBRI ISSUE BRIEF NO. 316 at 14 (April 2008). Many surveys have demonstrated that this one calculation does much to propel individuals to save for retirement.

Consistent with the SEC rules for investment advisers, AARP believes that the investment adviser must take into consideration diversification, suitability of investments and the participant's risk tolerance. As the proposed regulation requires, it will be necessary for the adviser to obtain additional information from the participant including an assessment of risk tolerance. In an effort to ensure that participants receive this important information, AARP submits that the regulation should require the investment adviser to be certified by an accredited organization or state agency in financial planning issues.

If the investment adviser deviates from the computer model recommendations, in any respect, the adviser must provide to the participant, in plain English and in writing, an explanation of the reasons for the deviation and the different investments and investment allocation(s). In particular, the disclosure must also contain a written explanation as to why the suggested investments with the particular fees were chosen for this participant as opposed to other investment choices with lower fees. The proposed regulation should require this written explanation to be provided to the participant at least seven (7) days before the meeting with the adviser. The Department's requirement that the adviser provide an explanation to the participant no later than 30 days after the meeting with the adviser is ineffective. If the written disclosure and explanation do not occur early enough to be incorporated into the participant's investment decision-making process, it is untimely. By the time the adviser provides the proposed explanation the participant may have already acted upon the adviser's advice. On this, the regulation and Class Exemption provide too little protection, too late.[4]

[4] As the Department well knows, after-the-fact enforcement leads to no enforcement. If the adviser were to violate the regulation's requirements and the participant loses money due to the adviser's advice, under current case law, the participant may well be left without a remedy under ERISA. *See, e.g., Amschwand v. Spherion Corp.*, 505 F.3d 342 (5th Cir. 2007), *cert. denied*, 128 S. Ct. 2995 (2008). Moreover, fiduciary advisors may not be responsible for losses resulting from investment choices made by participants, *see* ERISA § 404(c)(1)(B), because even if an investment advisor gives bad advice breaching its fiduciary duty, technically the participant is making the "decision" to rely on the advice.

Audit

We agree with the proposed regulation that annual audits should be required to ensure that to the extent the plan offers both investments for which the financial institution receives fees as well as other investments, the advice must not be biased in favor of the investments with fees and whatever fees are levied must be reasonable. The audit should be focused on specific criteria, and the continued availability of the Class Exemption to that particular plan should be conditioned upon continued compliance with the exemption requirements. Significantly, the proposed regulation and Class Exemption provide no remedies for participants who are the victims of fiduciary breaches by conflicted advisers *See* n. 3, *supra.*

Effective Date

Because of the current turmoil in the markets and the potential for the new regulatory scheme that is presently the subject of Congressional action to impact advisers as well as participants and beneficiaries, AARP submits that the effective date of the proposed regulation and Class Exemption should be no earlier than the later of July 1, 2009, or 180 days after the date of publication of the final regulation.

Conclusion

Conflicts of interest are particularly disturbing when they impact participants' retirement accounts. A review of the recent market upheaval and scandals in the financial world should make it obvious that conflict-driven advice should be avoided, and to the extent permitted by law, common sense compels far more substantial and significant participant protections than the Department has thus far proposed. Without stronger participant protections, the proposed Class Exemption and regulation will lead us down a road of conflict of interest problems that ERISA has long sought to prevent. The recent turmoil in the financial market is yet another reminder of the deep problems that may be created by conflicts of interest. Indeed, the proposed regulation and Class Exemption open the door to inappropriate treatment of plan participants by plan fiduciaries that double as investment advisers. ERISA is designed to ensure that fiduciaries act solely in the interest of plan participants. This exemption falls short of that standard, and is thus highly objectionable and not in keeping with Congressional intent in PPA. We urge the Department to rescind the proposed regulation and Class Exemption.

Because we believe that the issues presented by this proposed regulation and Class Exemption are extremely important and section 408(a) mandates that the

Secretary must afford an opportunity for a hearing before any exemption from section 406(a) is granted, AARP requests that a hearing should be held; we, of course, would be pleased to testify.

AARP appreciates the opportunity to present its views on the Department's proposed regulation and Class Exemption concerning investment advice. Please do not hesitate to contact me at 202/434-3750 or Mary Ellen Signorille at 202/434-2072.

Sincerely,

David Certner
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Government Relations and Advocacy