National Association of Independent
Retirement Plan Advisors

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on behalf of NAIRPA

Comments Presented to the
Committee on Ways and Means
United States House of Representatives

Defined Benefit Pension Plan Funding Levels and Investment Advice Rules

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Thank you to the Chairman and to the members of the Committee for the opportunity to speak with you today. My name is Mark A. Davis and I am a Vice President and Financial Advisor with CAPTRUST Financial Advisors, headquartered in Raleigh, North Carolina. I have practical experience on both sides of the independent investment advice issue, having worked as an education specialist for both a major mutual fund company and a major broker-dealer, and served as an independent advisor for ten years now. I am a strong supporter of independent investment advice.

CAPTRUST Financial Advisors serves as registered investment advisor and fiduciary to over 450 plans representing more than $22,000,000,000 in assets and more than 800,000 participants. We provide fiduciary investment advisory services both to sponsors of qualified retirement plans and to participants within many of those plans. We are independent and fully disclose all fees.

I speak to you today on behalf of the National Association of Independent Retirement Plan Advisors (NAIRPA). NAIRPA is an association of independent registered investment advisors who focus on delivering independent, conflict free advice at both the plan sponsor and participant levels. What that means is our fees are the same regardless of the investments that are selected. Our members provide advice to plans covering millions of participants.

Current Situation

The current situation for investment advice can probably best be described as confusing. The provision of investment advice is not governed by a clear set of law and regulations. Guidance is a mishmash of DOL advisory opinions, information bulletins and prohibited

transaction exemptions that allow conflicts to exist that leave a lot of apparent wiggle room for practices that I think are very troubling. Work-arounds that are at least on the surface enabled by the current environment have lead plan sponsors and participants to think they are getting "advice", when advice cannot be given. And the conclusions of an advisory opinion are sometimes stretched to fit circumstances that I find it hard to believe were contemplated by the regulators at DOL/EBSA.

Something needs to be done legislatively to encourage independent advice, and bring clarity to this critical aspect of retirement security. We need a fresh start. I applaud you, Mr. Chairman, and this Committee's leadership in examining this important issue, as well as Chairman Miller and Mr. Andrews for exploring ways to address this matter legislatively.

Current rules and practices are so confusing that plan sponsors and participants do not even know if they are getting advice. According to the 2007 Annual Survey of the Profit Sharing Council of America, more than 59% of sponsors of plans with 200 or fewer participants responded that they offered investment advice services to their participants. More than 70% of those sponsors say that the advice is delivered as "One on One Counseling (In Person)". Most plans of that size are sold and serviced through the brokerage model and most brokerage firms ardently claim that their brokers are not allowed to provide advice so as to avoid potential ERISA fiduciary status. So more than 40% of all small plan sponsors think they are offering advice when in fact the people these plan sponsors think are giving the advice claim that they are not giving advice at all.

It is easy to see how this happens. A recent RFP from a leading broker-dealer clearly states in the middle of a lot of fine print that the broker-dealer is not a fiduciary, and that the selection and monitoring of the plan's investment options are the responsibility of the plan fiduciary (that is, the employer). But the employer should be forgiven for thinking he has received "advice", because the first pages of the proposal, with color highlights, offers the "proposed investment menu". This same broker-dealer relies on the SunAmerica advisory opinion (Advisory Opinion 2001-09A) to provide participant level advice through an independent computer model. That can be a good thing, and should be encouraged if done properly. But this broker implies that the financial advisors will provide off-model advice, which under current rules would not be appropriate.

(Sometimes brokers and others that cannot legally provide advice, because they are not independent, arguably get around the rules by calling it "education" or "guidance", leveraging terms from DOL IB 96-1 in an attempt to be sheltered from the prohibited transaction issues that would arise if conflicted advice were given. So sponsors and participants think participants are getting "advice", but their vendors, who are prohibited from providing advice because it would be conflicted, call it by another name. Another case of a patchwork of rules causing confusion.)

Another concern is that brokers and advisors can view participant education and advice sessions as an opportunity to prospect for other business. This is understandable, but can

be abused very easily. Several times in the past year I have heard stories of brokers encouraging participants to take in-service withdrawals from Plans into IRA's managed by the same broker in order to invest differently (and more expensively) than the Plan would allow. This is precisely why conflicted advice should be clearly prohibited.

The SunAmerica opinion has formed the basis for a lot of participant-level advice arrangements, and most of those arrangements, which use an independently developed computer model to generate advice, provide cost-effective, unconflicted advice, to plan participants. That opinion was for a certain set of circumstances, though, and I am concerned that it has sometimes been stretched to "fit" circumstances that were not contemplated. (It is the job of attorneys and other advisors to stretch whatever rules are out there to the limit, so I don't mention this so much as a criticism of the providers as a criticism of the state of current law and regulations.) The opinion says that in the specific situation for which the opinion was requested, it is ok for the model to include only a subset of the investment options available under the plan, provided it is the plan fiduciary that chooses the subset and the options include a variety of risk/return characteristics. Now, it is very easy to envision how this can go wrong if we just apply that at face value, as if this opinion were a broadly applicable regulation. We have heard of situations where not all investment funds available under the plan are included in the computer model when it is applied to the plan. Computer models are generally built, as the SunAmerica opinion anticipates, with certain "asset classes". If plan menus are constructed with only certain funds eligible for use in those asset classes, the independence the opinion perceived is compromised. To me, it seems obvious that when the funds that are included are proprietary and the excluded funds are not, or when included funds pay for shelf space and omitted funds do not, the advice produced by the model is not independent. There clearly is a conflict in the selection of those funds and that conflict carries through to the output of the model. And of course, it is the participant who is harmed by the conflict. This simply should not be permitted.

In my mind it is difficult to separate the fee disclosure and investment advice issues. Without knowing how a vendor, broker or advisor is compensated, and how much and from whom, how can a fiduciary possibly evaluate the recommendations they are being given? Most plan sponsors have no idea how the brokers with whom they work are compensated. Nor do they know or understand the financial relationships that are involved in the creation of the "platforms" of investments offered by many vendors particularly, though not exclusively, in the small plan market. The vendors are conflicted when they create platforms and the brokers are conflicted when they offer certain platforms to their clients. At all levels of the marketplace, it is routine practice for sponsors to only be offered either investments that are proprietary to the vendor or investments that pay for shelf space on the vendor's platform. We regularly see even large market plans being offered only funds that pay some level of "revenue share" to the vendor to be on the recordkeeping platform. While there is nothing inherently wrong with revenue sharing when it is used to properly allocate fees to the appropriate party providing a particular service, it can be abused and become a "pay to play" mechanism where only those funds that revenue share, and thus allow fees to be hidden inside investment costs, get to be seen by sponsors and participants. All these problems can be

addressed by the engagement of an independent advisor to assist the plan sponsor with fund selection.

Pre-PPA vs Post-PPA

The Pension Protection Act of 2006 brought sweeping change to our business. I believe Congress did a great thing in incenting Automatic Enrollment protocols and I applaud the efforts of Congress and the new Administration to further press for more. However, Automatic Enrollment also creates an even larger group of workers that need knowledgeable, unconflicted, investment advice. As part of the movement toward "opt-out" savings, PPA also brought new rules on Qualified Default Investment Alternatives (QDIAs) that I think are positive, if properly implemented. However, companies who offer products for the QDIA market don't always take responsibility for their product. There is at least one major firm in the marketplace that has its clients (that is, the plan sponsors) sign off as fiduciary and investment manager for their QDIA solution as a means of getting around the current prohibited transaction rules. Once again, sponsors think the vendor is providing advice but by their signature the plan sponsor is taking responsibility not just for oversight of the vendor, which is what they think their role is, but rather for the construction, management and oversight of the portfolios themselves. I know from experience that not all clients, regardless of size, understand what they are signing in this situation. That clearly is not what PPA intended. What is particularly galling is that these plan sponsors probably think they got good "advice" from the vendor.

We have not seen much, if any, impact on the provision of investment advice from the new PPA investment advice provisions. Providers may be waiting for final regulations. If anything, DOL regulations on the PPA advice provisions, currently on hold under the new administration, muddied the waters on the provision of investment advice. Although PPA did permit some conflicted advice, there were serious protections that attached. The prohibited transaction exemption that was included in the final regulation went well beyond PPA, permitting conflicts that even the authors of the regulation acknowledged were not contemplated by PPA. I think harm will be done if the final regulation is implemented that would permit so-called "fee leveling" at the individual, not the firm, level, and permit "off-model" advice. I am hopeful that the current administration will be making some changes in the near future that alleviate my concerns. The fact that PPA did not preclude DOL putting out an exemption that would allow clear conflicts is proof that PPA did not do what needed to be done.

What Needs to be Done

I am very excited about the future for retirement savings. I believe that the renewed focus on retirement savings brought by President Obama as recently as Labor Day weekend bodes well for the retirement savings futures of American workers. Expanding savings opportunities is a critical part of securing retirement. However, it is critical that conflict-free advice, along with improved disclosure, accompany improved savings opportunities.

Congress should establish that retirement plan sponsors and participants deserve the highest standard of care from those who advise them on the investment of retirement savings. NAIRPA encourages the Committee to consider legislation clarifying the need for independent advice such as the advice provisions in the bill reported out by the Education and Labor Committee (HR 2989). It is especially critical that this Committee act because not all tax-favored plans are subject to ERISA, and unless Internal Revenue Code Section 403(b) and 457(b) plans are covered without regard to their ERISA status, some workers will go unprotected.

I have worked for an investment provider, a broker-dealer, and now I am working as an independent advisor. While most companies are highly ethical and most education specialists are true professionals, it is not wise to rely on a regulatory or legislative framework that presumes that these employees will always separate themselves completely from doing what is in the best interest of their employers. That is contrary to human nature and is asking for trouble.

There is a whole industry of professionals in this country that is ready to help American plans and American workers, including those with minimum balances who may never be good candidates to be clients of the major financial services firms. We will disclose fees, avoid conflicts, educate, console, coach and yes advise American workers in the 21st century. American workers deserve to get advice from someone who has only that worker's best interests in mind. I urge this Committee to take action to make that happen.