Written Testimony of Stephen McCaffrey

On behalf of the
Plan Sponsor of America ("PSCA")

Before the U.S. Department of Labor
Employee Benefits Security Administration
Hearing on the Proposed Conflict of Interest Rule
August 10, 2015

Good afternoon, my name is Stephen McCaffrey and I serve as the Chairman of the Board for the Plan Sponsor Council of America, also known as "PSCA." I would like to thank the Department of Labor ("DOL") for the opportunity to testify today and share PSCA's views on the proposed Conflict of Interest Rule ("Proposed Rule").

PSCA was established in 1947 and is a diverse, collaborative community of employee benefit plan sponsors, working together on behalf of more than 7 million employees to help Americans save for retirement and expand on the success of the voluntary employer-sponsored retirement system. We are the nation's leading advocate for plan sponsors; we represent the interests of plan sponsors of all sizes from around the country – 44 percent of our members have fewer than 100 employees, and 34 percent have fewer than 50 employees. Our members also include recordkeepers, advisors, and other types of providers. In this regard, PSCA is able to speak to the impact the proposed changes may have on many different stakeholders.

The number of American workers saving for retirement has grown dramatically over the past 40 years. The growth in the level of participation in employer-sponsored retirement plans and IRAs have significantly altered the market for retirement advice. As a result, the role of a fiduciary is even more critical.

PSCA appreciates the DOL's continued efforts to update the fiduciary standard to reflect the fast-changing investment and savings landscape. We also appreciate the DOL's careful consideration and adoption of many of PSCA's views on this important topic over the years. PSCA's members have spent the last several months meeting on a weekly basis to carefully evaluate the Proposed Rule. As we continue to understand the rule, we stand ready to work with the DOL to develop and implement a rule that is in the best interest of all American workers.

PSCA supports the core goal and approach of the Proposed Rule in extending the protection of ERISA's fiduciary standards. We believe our retirement system will be greatly strengthened by ensuring that investment advice is provided in the recipient's best interest.

PSCA views the Proposed Rule as a means to protect pre-retirees and retirees as they approach the phase where they begin withdrawing retirement assets. However, after reviewing and discussing the Proposed Rule with a significant segment of our members, it is clear that additional clarification on many of these provisions is needed to avoid regulatory confusion. As the DOL works to improve the Proposed Rule we want to recommend that the final regulations include additional examples and model language to sharpen many of the definitions under the rule.

The purpose of my testimony today is to discuss in greater detail several of the clarifications we seek and why they are necessary. PSCA hopes today's testimony will help the DOL to:

- improve the Proposed Rule;
- mitigate the potential for any unintended consequences; and
- strike the proper balance between investor protections and flexibility.

PSCA submitted a comment letter on July 21, which provides an extensive look at the Proposed Rule. My testimony today will focus on 2 main points:

- First, PSCA wants to ensure that American workers continue to receive balanced, factual investment education. PSCA is concerned that the Proposed Rule, as written could negatively impact access to, and the distribution of, investment education materials. PSCA members are concerned that narrowing IB 96-1 could have unintended consequences that would be particularly harmful to small employers and participants. Plan sponsors are concerned that the availability of educational services will be limited or become more costly if the Proposed Rule is finalized without additional clarification. Our principal concern is that if investment education is deemed to be "investment advice," providers may no longer offer these services or will impose advisory-level fees, making the information unattainable for many employees.

- Second, we are concerned about the potential adverse impact of the Proposed Rule on small plans.

With respect to my first point, PSCA believes that the current guidance under IB 96-1 should be preserved in its entirety. In our view, IB 96-1 has worked well in providing a reliable and workable model with which plan sponsors, service providers, participants, and other stakeholders are familiar. This familiarity and reliability would only become more important as the marketplace adjusts to the changes of the Proposed Rule.

Specifically, PSCA would recommend amending the Proposed Rule, so that investment education materials that include asset allocation models or interactive investment materials would be allowed to identify investment alternatives available under the plan without being deemed as "investment advice." We would underscore that the absence of these helpful asset allocation models and interactive investment materials would increase decisions required of participants during plan enrollment and investment selection processes. This, in turn, would undermine sponsors' efforts to increase appreciation for, and participation in, the plan.

While PSCA understands the DOL's concern about steering participants to particular investments, we believe that the identification of specific investment options in asset allocation models and interactive investment materials helps participants understand and "connect the dots" between general information on asset allocation and corresponding investment(s) in a plan. Importantly, one without the other runs the risk of failing to educate a participant on how to effectively use an employer's plan – a net detriment to his or her best interest. Accordingly, PSCA believes that if the Proposed Rule were to be finalized without changes, it could decrease the value and effectiveness of investment education.

To underscore the importance of this, I would like to share with you results from PSCA's 57th Annual Survey, which shows that the most common reasons for providing education among plans (of all sizes) was to increase participation (77.5 percent), increase appreciation for the plan (72.9 percent), and increase deferrals (74.9 percent). For plans with 1-49 participants, 78.1 percent of respondents indicated that plan education was provided to increase appreciation for the plan.

Our concern is best demonstrated by the following anecdote given by one of our plan sponsor members:

> We hired XYZ to provide investment education services to our employees. They offer a robust program that tailors the educational opportunities for early-, mid-, and late-career employees. One thing we really like about the program is that if a participant wants to learn more than just the general information from online and various program seminars, he or she can schedule a telephone call with an XYZ certified financial planner and talk about factors specific to the employee. For example, benefit opportunities inside and outside of the employer, prior marriages, etc. The certified financial planner uses this information, as well as the employee's risk tolerance and time horizon to help construct a broad asset allocation model based on the employee's personal circumstances. What we have noticed when we have looked in the past at IB 96-1 is that the XYZ representative would be able to utilize our plan's investment options to provide examples of what the plan currently offers to satisfy an allocation in the model provided to the participant. For example, "the asset allocation model suggests investing x% in large cap equities; the plan currently offers these funds as large cap equity options . . ." We believe that this last step – connecting the asset allocation model with specific investment options

> under the plan – ties it all together for the participant. In our experience, participants are well aware that the references to specific investment options are intended to constitute education, not advice. We are concerned that the proposed regulation would prohibit our educational service provider from helping the participant connect the dots.

To the extent the DOL is unwilling to preserve IB 96-1 in its entirety, PSCA believes there are ways to permit the identification of specific investment options without risking the abuses described by the DOL if certain principles are taken into account. For example, proposals that are based on neutral, informative descriptions of the participant's options should be permissible under the carve-out. In providing this neutrality, the focus should be on the factually comparative nature of the information and whether it is being provided in a manner that does not rise to the level of a recommendation. In this regard, both the DOL and PSCA have been weighing the pros and cons of alternatives such as:

- permit the identification of specific investment options when the education is paid for on a fixed basis and presented in an un-conflicted manner;
- permit the identification of specific investment options when the education is provided by an independent third-party;
- permit the identification of specific investment options when the education discloses each available plan option in a given asset class; and/or
- permit plans to continue relying on IB 96-1, but do not extend this ability to IRAs because the marketplace for employee benefit plans is considerably different from the marketplace for IRAs. While IRA owners have access to an unlimited universe of investments, plan participants and beneficiaries select investments from a lineup selected by prudent plan fiduciaries.

We believe that each of these alternative solutions can address the concerns raised by the DOL and would permit plan sponsors to continue, albeit potentially at a greater cost, to provide valuable education in certain instances. However, as noted above, PSCA believes that service providers should be able to identify specific investment options under the principles established in IB 96-1 although it may necessary to subject certain service providers to additional conditions to ensure neutrality. Again, PSCA welcomes the opportunity to work with the DOL as it considers these and other alternatives.

With respect to our second point, PSCA is concerned about the potential adverse impact of the Proposed Rule on small plans. For example, the Proposed Rule's broad nature might create uncertainty or disruption in the small plan market that could diminish the availability of valuable plan administration solutions and stifle distribution of services that have heretofore satisfied the needs of organizational leaders and plan participants.

Our 57th Annual Survey of 401(k) and Profit Sharing plans suggests most employers look to their providers to deliver retirement education. For example, among plans with 50-199 participants that offered retirement planning education, 70.6 percent relied on a third-party for part or all of their education services and only 27.1 percent of plan sponsors delivered the education themselves. Conversely, of plans with 5,000 or more participants, 54 percent indicated relying on a third-party. Imposing the burden of developing these programs without the help of their providers could impact small employers' willingness to establish or maintain plans. Also, the absence of helpful asset allocation models and interactive investment materials would increase decisions required of participants during plan enrollment and investment selection processes. This, in turn, would undermine sponsors' efforts to increase appreciation for, and participation in, the plan.

PSCA believes the Platform Provider Carve-out should not be limited to large plan sponsors. We would recommend retaining the current construct of the carve-out so that it applies to plan sponsors of all sizes. PSCA does not support limiting the platform provider carve-outs to large plan sponsors for several reasons. Extending the carve-out to plans of all sizes would be more consistent with core ERISA fiduciary principles, would recognize that small plan sponsors are equally capable of understanding when a platform provider has financial interests, and would avoid the imposition of difficult administrative issues related to potential provider disruption and plan design restrictions.

As the DOL is aware, ERISA provides that a fiduciary must discharge his responsibility "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims." The scope of this duty is not conditioned upon the relative size of the plan sponsor. Rather, it applies equally to plan sponsors of all sizes. Thus, applying the carve-out regardless of size simply is more consistent with this fundamental ERISA obligation.

PSCA believes a decision by the DOL to exclude small plans from the platform provider carve-out would create confusion in the marketplace and potentially create an undue burden to certain small plan sponsors. Limiting the carve-out to large employers would in essence make every platform available to a small employer an advisory product. PSCA believes that small plan sponsors who want to use a platform but do not need to obtain related investment advice should not be subjected to the related increased costs of an advisory platform. In practical terms, PSCA agrees with the DOL that some small plan sponsors may not be as sophisticated as large plan sponsors and that those small plan sponsors should be protected when they obtain investment advice from a service provider. However, and as noted above, plan sponsors of all sizes are obligated to understand and uphold their fiduciary duties. There clearly are many small plan sponsors who – for various reasons – would benefit from having the same platform provider carve-out option that large plan sponsors have.

Importantly, investment sophistication is a matter of sophistication – not size. For example, a small plan sponsor that employs a sophisticated Chief Financial Officer may prefer to work with a service provider with access to a platform of investment options. If the plan fiduciary for that employer is comfortable making investment selection decisions and does not need the investment advice from the service provider, then excluding that small employer from the platform provider carve-out exposes that employer to the risk of greater burdens and costs referenced earlier without a clear corresponding gain. Today's marketplace makes investment advice available to those sponsors who need it. The disclosures required by the carve-out should help any size plan sponsor understand that investments presented within a platform are not intended to be fiduciary recommendations. Solidifying this understanding will help employers who need this assistance realize they must seek it through already available, but separate, services.

In addition, PSCA believes that an undue burden will befall plan sponsors if the platform provider carve-out is applied on a size basis as plans grow or decline in size since it is unclear how the use of platforms would be expected to change as the applicable threshold is crossed in either direction. Small plan sponsors are just as capable of recognizing that platform providers have financial interests with the offered investments and of understanding when they are providing investment advice. Moreover, the DOL already has promulgated regulations intended to address concerns about the ability of plan fiduciaries to evaluate service provider compensation and evaluate potential conflicts of interest. PSCA understands that the DOL may have concerns with respect to extremely small plans that are akin to IRAs. As such, if the DOL is unwilling to apply the platform provider carve-outs to plans of all sizes, PSCA recommends that they consider adopting a rule that only plans with a very small plan participation base – for example, between 5 and 10 employees – be excluded from the carve-out.

In closing, on behalf of PSCA, I would like to applaud the DOL's efforts to maximize consumer protection for plan sponsors, fiduciaries, participants, beneficiaries, and IRA owners while preserving flexibility within the plans. After listening to comments from other groups and members of the provider community, it became clear that many of their concerns – which I've outlined here today – result from the overly broad definitions under the Proposed Rule.

Thank you again for the opportunity to testify. I hope the views expressed here today will be helpful to the DOL as it works on finalizing the Proposed Rule. As always, PSCA looks forward to continue working with the Department of Labor and serving as a resource to your staff on this important issue.