

**TESTIMONY**

**Before the  
Subcommittee on Employer-Employee Relations  
Committee on Education and the Workforce  
U.S. House of Representatives**

**A More Secure Retirement for Workers: Proposals for ERISA Reform**

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Ladies and Gentlemen:

My name is Allen Reed, and I am here today on behalf of CIEBA, The Committee on Investment of Employee Benefit Assets of the Financial Executives Institute. CIEBA was formed fifteen years ago to provide a nationally recognized voice exclusively for ERISA-governed corporate pension plan sponsors on current fiduciary and investment issues. It is an organization representing over 140 of the largest corporate pension funds in the United States. Its membership consists of corporate financial officers who administer and manage, as fiduciaries, the investment of over \$1 trillion in retirement plan assets on behalf of over 15 million plan participants and beneficiaries. Attached are examples of the types of materials that CIEBA prepares to provide information to its members and other parties involved in the oversight of plan benefits on pension plan and regulatory issues. (Fall, 1995 Primer on Pension Plans Regulated by ERISA; and, September, 1998 Primer on Defined Contribution Plans)

Because of this background, CIEBA's members are uniquely situated to comment on the ERISA fiduciary rules and related issues in the context of these hearings on ERISA reform. Our members serve as ERISA fiduciaries facing these issues on a daily basis, and have been witness to the vast changes in the pension and financial industry over the past 25 years since ERISA was signed into law. Our perspective includes both the role of the plan sponsor and, because many of our members manage pension plan investments in-house, the role of an asset manager.

Overall, we believe that the ERISA fiduciary rules have worked quite well. The general fiduciary duties of loyalty, prudence and diversification spelled out in section 404 of the statute provide a flexible framework within which to manage and administer pension plans, discouraging abuses while not restricting the types of investments that plan fiduciaries may

make. However, another aspect of the fiduciary rules -- the prohibited transaction provisions -- is not as flexible and has created numerous problems for pension plan fiduciaries.

Today, I would like to focus on two specific areas of concern to the CIEBA members. The first is the availability of investment education and advice to participants in participant-directed defined contribution plans. Everyone seems to agree that education and advice is a good idea, but the issue is how best to deliver these services to plan participants. The second is the ERISA prohibited transaction provisions, which in some cases have inadvertently imposed costs and burdens on pension plans.

#### I. Investment Education and Advice

Over the past 25 years, there has been an increasing trend towards providing retirement benefits through defined contribution plans. In a defined contribution plan, the employee and in many cases also the employer make annual contributions to the employee's individual account under the plan, and the employee's retirement benefit is based on the accumulated balance in his or her account. The account balance at retirement will depend on the level of contributions over the employee's working career and the investment experience of those contributions, so that the investment risk is on the employee.

This trend is clear among CIEBA members. In just the four years from 1994 to 1998, the number of participants in defined contribution plans of CIEBA members increased from 4.6 million to 5.3 million, and assets in those plans doubled from \$234 billion to \$471 billion. On average, this indicates that the typical participant account balance grew from about \$51,000 to about \$89,000 in just four years. Given the substantial market returns in 1999, I believe it is safe to assume that the average participant balance is approaching \$100,000.

These plans are increasingly giving participants control over the investment of their plan accounts. Generally, participants have a choice among options selected by the employer, often mutual funds or other commingled investment vehicles, but some plans now offer self-directed brokerage windows that permit participants to invest in a substantial number of mutual funds and in individual stocks and bonds.

In order for participants in these plans to effectively accumulate assets for their retirement, they must be knowledgeable about financial and investment matters or be able to obtain qualified financial advice. As assets continue to grow and the array of financial products multiplies, the need for education and assistance becomes ever more pressing. Participants often find the financial landscape confusing, and it is difficult for many of them to determine the best allocation of their account balances among the various options offered by their plan.

An important way to address this issue is through education. CIEBA has long been an advocate of investment education for plan participants, and many CIEBA companies have undertaken comprehensive participant education efforts. These education programs have covered general investment concepts such as the power of compounding, the risk of inflation, asset allocation and diversification. They also may cover estimating retirement income needs, which is an important first step towards developing a retirement savings strategy. The programs are provided through a number of different vehicles, such as phone voice response systems, newsletters and brochures, internet sites and seminars. Attached to this testimony is a chart of the percentage of CIEBA members providing these various services from 1994 through 1998, which demonstrates the increasing trend towards providing participant investment education. These education programs often result in an increase in employee contributions to their plans, which shows that the programs also help in making employees aware of the importance of retirement savings.

Prior to 1996, there was some concern in both the plan sponsor and financial services communities that providing these education programs could create a risk of fiduciary liability. This is because ERISA treats a person who provides "investment advice" to a plan as a fiduciary to that plan subject to the ERISA duties of loyalty and prudence, as well as the prohibited transaction rules. Many companies avoided providing education due to concerns that the education would be viewed as "investment advice." Following discussions with plan sponsor groups such as CIEBA and with the financial services industry, the Department of Labor responded to this problem by issuing an interpretive bulletin that describes four categories of investment education that do not constitute "investment advice" under ERISA -- information about the plan, general financial and investment information, asset allocation models, and interactive investment materials. If an education program falls within one of the four categories, then the fiduciary responsibility rules would not apply to the provider of the education. The

effect of the interpretive bulletin has been to encourage more investment education efforts, and the Department deserves credit for responding to CIEBA and others by providing timely and helpful clarification in this area.

However, investment education alone is not sufficient. Many plan participants are asking for more guidance -- they want to be told how to apply the general financial and investment concepts to their particular situations. What they desire is the type of assistance that would constitute "investment advice" under ERISA.

The issue is not whether there is a need for such advice -- the need seems to be there -- but rather how best to provide it. The employer community is not well situated to do so. Many employers lack the expertise and the resources to provide one-on-one investment advisory services to plan participants. While plan sponsors could retain outside professionals to provide investment advice, there are no clear standards for monitoring the quality of investment advice. Even if there were, effective monitoring simply may not be possible because the advice will differ from participant to participant -- the most effective investment advice is that which takes into account tax, insurance and estate issues for the particular individual. The average CIEBA member has almost 38,000 employees, making it impractical to oversee the individualized advice furnished to each one.

CIEBA urges Congress and the Department of Labor to find a way for participants to be able to seek their own advisers with minimal involvement from the plan sponsor. The plan sponsor then will not be reluctant to make the advisory services available because it would be protected from liability, while the participants would be able to obtain advice tailored to their personal financial situations. There is a precedent for this approach. Under current ERISA regulations, an employer can make certain arrangements such as a payroll deduction IRA available to employees without becoming the sponsor of the arrangement, by limiting its role to providing certain information and ministerial services. So long as the employer only provides such information and services and does not endorse the program, the employer avoids becoming subject to ERISA. A similar type of process could work well in the investment advice area.

To encourage plan participants to obtain investment advice, they should be allowed to pay for the advisory services out of their plan account assets, or more preferably by payroll deduction on a pre-tax basis. Many advisers charge fees for their services, and participants may

not have sufficient savings to use their non-retirement assets to pay those fees. In light of some uncertainty in this area, it would be helpful for the government to clarify that the payment of reasonable fees for advisory services is a reasonable expense payable from plan assets, and does not violate the ERISA fiduciary rules governing retirement plans.

## II. Prohibited Transactions

I expect that you will be hearing a number of comments over the course of these hearings about the ERISA prohibited transaction rules. The original intent of these rules was to provide additional protections for plans, out of concern that the general fiduciary duties of loyalty and prudence did not go far enough. While they have likely had the effect of discouraging abuses, they also have had the effect of restricting investment opportunities.

The restrictive effect of the prohibited transaction provisions has become increasingly evident over the past 25 years. As the financial services industry has consolidated and developed new investment products and strategies not contemplated in 1974, compliance with these rules has become more problematic. The industry changes and developments frequently raise technical issues under the prohibited transaction rules, and, in some cases, the effect has been to deprive ERISA plans of benefits that have become available to the rest of the investment industry.

Congress anticipated that the prohibited transaction rules could limit many transactions that would be beneficial to ERISA plans, and thus provided for exemptive relief from those rules. ERISA itself contains a series of statutory exemptions, covering a number of the more common arrangements and relationships entered into by plans. In addition, ERISA directed the Department of the Treasury and Department of Labor to establish an administrative exemption process, which is now administered principally by the Department of Labor.

Over the years, the Department of Labor has issued a number of class exemptions providing general relief for common types of transactions, and thousands of individual exemptions for specific transactions. A good example is a class exemption that CIEBA requested for in-house asset managers, known as the "INHAM" exemption. This exemption provides general relief for sophisticated in-house managers from the technical prohibitions under

ERISA that limit dealings with so-called parties in interest, in situations where there is no risk of abuse because the in-house manager has no affiliation with the parties in interest. The INHAM exemption has assisted my company and others in entering into transactions that previously were not available or required us to seek an individual exemption.

The Department generally is willing to grant relief from the technical party in interest prohibitions, although subject to numerous conditions and limitations. It is much less willing to grant relief from the fiduciary conflict of interest and self-dealing prohibitions, even where the transaction presents minimal potential for abuse. As a result, transactions that are clearly beneficial to a plan may nevertheless not be exempted.

An example of these problems is the current controversy regarding cross-trading. Where a manager has two accounts, one wishing to buy a security and the other wishing to sell the same security, the manager may want to “cross” the trades between the accounts rather than going to a broker-dealer. This saves transaction and market impact costs. CIEBA estimates that denying cross-trading opportunities to plan fiduciaries results in additional transaction costs for plans of about \$500 million per year for U.S. equities alone -- only one segment of the overall securities market. The benefits of cross-trading are clear.

Because the manager is an ERISA fiduciary who is on both sides of the trade, there is a potential conflict of interest prohibited by the prohibited transaction rules. As a result, a number of investment management firms have sought prohibited transaction exemptions for cross-trading. While the Department has proposed a class exemption for so-called “passive” cross-trading, which is limited to index and model-driven funds, it has been reluctant to issue a class exemption for cross-trading by actively-managed accounts.

As the customer of the cross-trading managers in these situations, we believe that our plans would benefit from cross-trading and that those benefits outweigh the potential risks. Furthermore, the potential risks can be minimized by applying appropriate conditions in a class exemption that focus on determining a fair price for the cross-trade and assuring adequate disclosure of the transactions. However, the Department has not yet responded to the comments from CIEBA and others, and appears reluctant to sufficiently balance the benefits and risks of permitting active cross-trading. (Attached are CIEBA's written comments submitted to the Department of Labor on its proposal for a Class Exemption for Securities Cross-Traded by

Index/Model-Driven Funds and a copy of CIEBA's testimony regarding Cross-Trades of Securities by Actively Managed Funds.)

The potential abuses that can exist in cross-trading have been addressed by the Securities and Exchange Commission. Under the Investment Company Act of 1940, managers of mutual funds may cross-trade securities subject to appropriate policies and procedures for determining price and reporting to the funds' boards of directors. Many commentators have suggested the Investment Company Act standard as a model for the Department of Labor to use in a class exemption, but the Department has thus far resisted that approach. The result is that investment managers can cross trades for mutual funds and other non-ERISA managed accounts, giving them the benefits of cross-trading, but are required to treat ERISA plans differently by excluding them from these transactions. The ERISA plan participants and beneficiaries would be better served by a regulatory framework that applies the same rules to similarly-situated investors.

What is needed in the prohibited transaction area is a more flexible exemption process that properly balances the potential risks to plan participants with the benefits of the particular transaction. This process should be able to address the wide range of investment activities of different plans, and be responsive to the constantly changing environment of the financial marketplace.

### III. Conclusion

I appreciate the opportunity to discuss these issues before this subcommittee and to participate in the consideration of ERISA reform. The investment education and advice issue is an increasingly important one, and to quote Chairman Boehner's remarks at the opening of these hearings -- "to the extent we can enhance private access to expert investment advice and education, we will have served our constituents well." The prohibited transactions and the exemption process also are important, because prohibited transaction issues have come to play an increasingly disproportionate role in the investment process for ERISA plans. I look forward to working further with the subcommittee members on these and other ERISA issues.