

**MEMO# 11758**

March 23, 2000

## **INSTITUTE TESTIFIES ON ERISA REFORM**

[11758] March 23, 2000 TO: BOARD OF GOVERNORS No. 16-00 FEDERAL LEGISLATION MEMBERS No. 3-00 PRIMARY CONTACTS - MEMBER COMPLEX No. 20-00 PUBLIC INFORMATION COMMITTEE No. 10-00 RE: INSTITUTE TESTIFIES ON ERISA REFORM

On March 9 and 10, the House Education and the Workforce Subcommittee on Employer- Employee Relations held hearings to discuss reforms to the Employee Retirement Income Security Act of 1975 (ERISA). Margaret Raymond, Assistant General Counsel of Fidelity Investments, testified on behalf of the ICI. The Institute submitted additional written comments. The hearings focused on whether ERISA's prohibited transaction provisions should be updated to reflect the changes in the financial services industry over the past 25 years. The first hearing examined the prohibited transaction rules as they affect the ability of 401(k) plan participants to obtain investment advice. The second hearing discussed whether changes to the prohibited transaction rules—and the Department of Labor's process for providing relief from the rules—are warranted. Investment Advice. At the first hearing, witnesses from the financial services industry, including Ms. Raymond, called for changes to ERISA to allow plan service providers, such as mutual funds, to provide investment advice to participants in 401(k) plans. Current law prohibits a mutual fund company and other investment advisers from giving investment advice to plan participants about products distributed or managed by the company, adviser or their affiliates. Ms. Raymond noted that ERISA's existing fiduciary standards will assure that such investment advice is prudent and appropriate. The Institute, in its written statement, recommended that Congress provide a statutory exemption enabling plan participants to obtain investment advice, provided that the provider of the advice meet certain conditions. However, Professor Joseph Grundfest, former SEC commissioner and co-founder of the Internet-based investment advisory service Financial Engines, Inc., suggested in his attached testimony that mutual fund companies suffer from a conflict of interest when they seek to provide investment advice to retirement plan participants. The Institute responded to Professor Grundfest in the attached letter delivered to subcommittee members and staff at the hearing. Professor Grundfest warned in his statement of a "real danger" that mutual fund companies "can and will shade" their information services to obtain higher fees. He described information services that could contain advice that was not in the best interest of plan participants. In closing, Grundfest recommended that an adviser independent of a plan's fund provider should be permitted to offer advice to the plan's participants; a mutual fund adviser should be allowed to offer advice on its own funds if it meets certain criteria; and Congress should clarify that an independent financial adviser is not prohibited from providing advice where the mutual fund provider pays all or part of the independent adviser's flat fees. Nevertheless, several witnesses at the second hearing testified that prohibiting investment advice from plan providers is not warranted. They called for changes to ERISA to allow for such advice so

long as participants received full disclosure of the financial service firm's advisory product and relevant fees. They also cited the securities laws as an example of how full disclosure minimizes potential conflicts of interest in providing advice. Subcommittee members concurred that investment advice should be provided to 401(k) plan participants if appropriate safeguards are in place. Prohibited Transactions Rules. At the second hearing, witnesses discussed ways to amend the prohibited transaction rules. The Institute's statement recommended that the exemption process (handled by the Department of Labor) could be made more efficient by changing the standards under which exemptions are granted. Specifically, the Institute said that the Department of Labor should consider relevant, existing federal laws and regulations, such as the securities laws, when processing exemption requests. In his closing statement, Ranking Member Andrews (D-NJ) said that while nobody advocates changes to the prohibited transaction rules to allow "rampant" self-dealing, there is agreement among members of the subcommittee that burdening plans and participants with the needless transaction costs under the current rules is unnecessary. The subcommittee will hold an additional hearing in April. Chairman Boehner (R-OH) hopes to develop legislation to modernize ERISA's regulatory structure for managing pension assets. Matthew P. Fink President Attachments Note: Not all recipients receive the attachment. To obtain a copy of the attachment referred to in this Memo, please call the ICI Library at (202) 326-8304, and ask for attachment number 11758. ICI Members may retrieve this Memo and its attachment from ICINet (<http://members.ici.org>).

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