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Protecting Retirement Savings
The Case for a New Department of Labor Fiduciary Rule

Delivered to Congressional Staff on February 14, 2022

I am speaking today on behalf of PIABA, the Public Investors Advocate Bar Association. I would like to take a few minutes to talk about how retirement investors are harmed when the advice they receive is infected with conflicts of interest.

There is ample evidence that investors believe their financial advisors are obligated to give them advice that is in the investors' best interests, including an interesting study conducted several years ago by AARP. This belief has been cultivated from decades of marketing by the financial services industry, which has presented itself as a purveyor of trusted advice. Firms regularly tell investors that they can be trusted, and will be there for investors throughout life, providing advice and guidance at key milestones.

As a result, investors entrust their financial advisors with their retirement savings, and rely on the advice they receive. Investors do not understand how conflicts of interest might taint that advice. And even when a conflict is disclosed, many advisors then feel free to act on their conflicts, what researchers refer to as "moral licensing."

In many cases, those who are giving investment advice in connection with retirement plans are not captured under ERISA as fiduciaries. In 1975, the DOL adopted a regulation that established a five-part test that must be satisfied for an advice giver to be captured as a fiduciary by the statute. The five-part test requires that the advice be with respect to securities or other property, be given on a regular basis, pursuant to a mutual understanding that the advice will serve as the primary basis for the investment decision and that the advice be individualized.

While brokers regularly give advice to retirement investors that purport to meet these five prongs, their IRA agreements regularly disclaim at least one of the prongs. Firms have clients sign agreements that state the investment advice is not to be given on a regular basis or that it will not serve as the primary basis for the investment decision, regardless of the actual facts and circumstances of the interaction between the broker and the client. By utilizing this type of language in the account agreements, brokers believe they are able to write themselves out of the five-part test, ensuring that they cannot become ERISA fiduciaries. This means conflicts of interest can affect the advice brokers are giving to retirement investors.

So, under the current system, retirement investors regularly receive advice that reflects the conflicts of interest prevalent throughout the industry, advice that is not regulated as fiduciary advice under ERISA. Brokers defend their recommendations, presenting them as consistent with their regulatory obligations imposed by the SEC and FINRA. However, their advice often benefits the broker at the expense of the investor.

Each year, PIABA attorneys represent hundreds of retirement investors who have lost money due to the misconduct of their financial advisor. The stories I am going to tell are real cases.

First, I want to tell you about Bob. He was approaching retirement and had a 401(k) worth about half a million dollars. Right after he retired, Bob's broker convinced him to roll the 401(k) into an IRA and then invest in four non-traded REITs and Business Development Companies. These are complex products that tend to generate high levels of income. But that income does not come without risks. These products are often illiquid and can face significant risk to principal. Bob's broker and his firm, meanwhile, earned a substantial commission, upwards of 10%. Unfortunately, Bob ended up losing about 60% of his account value, and also lost out on about $100,000 in gains he would have realized had he been invested in products that were simpler, such as those focused on traditional equities and bonds. However, had Bob's broker recommended a fixed income bond fund, he likely would have earned a small fraction of the fee he earned on these alternative investments.

Bob's story mirrors so many others. For example, when Susans's husband passed away in his mid-50's, Susan inherited his pension fund worth half a million dollars. Susan's broker told her she should be invested in income producing instruments which would also grow, so that Susan would be provided for throughout her retirement. The broker invested Susan in three non-traded REITs and an annuity. Like Bob's broker, Susan's broker earned high commissions on each of these products. While these products did initially generate income, like her broker said they would, they were also illiquid. Susan could not get her money out of the REITs unless she sold them on the secondary market at a substantial discount. She could not get her money out of the annuity without paying a substantial penalty. And, to make matters worse, the REITs lost money.

Marie put herself through college and law school, working as a police officer. She was able to accumulate retirement savings of approximately $1 million after a long career. She sought out investment advice, because, although she was well educated, she was unfamiliar with the markets. Marie opened an account with James, who recommended that she invest her retirement funds in index annuities and non-traded REITs. Again, the broker recommended alternative investments intended to generate income but with little regard for their risks. Marie soon found out that she could not access her principal, which had declined far more than she was comfortable with. And of course, the broker earned substantially higher commissions than he would have earned had he recommended a fixed income bond fund.

Grant and Dorothy were a retired couple who were both in their 70's when they turned their retirement funds over to their broker. The broker decided it would be appropriate to employ a complex strategy that was geared towards generating growth while hedging against catastrophic

bear market losses. Unfortunately, with the strategy, in just seven months, the broker lost almost 20% of their $150,000 in retirement funds. During this same time period, the broker earned $15,000.

In each of these cases, for each of these retirement investors, the broker recommended a complex, alternative investment. Brokers often justify higher commissions and fees when recommending complex products because it takes the broker time to understand the product, when in fact these fees represent the riskiness of the product and a financial incentive to brokers to sell them instead of less risky products. While an investment recommendation may offer a particular benefit, like expected income or hedging, the accompanying market and liquidity risks are downplayed or ignored entirely. There is no question the conflicts described in the cases I discussed led to questionable advice. Because these brokers ensure that they will not be subject to ERISA's fiduciary standards, they know that conflicts are permitted, just so long as they can point to some marginal benefit to the investor.

As I mentioned, brokers are able to carve themselves out of ERISA by using carefully drafted IRA agreements. These contracts state that the broker's advice "will not be on a regular basis" or "will not serve as the primary basis for the investment decision." Unfortunately, while these contracts may set forth these limitations in a writing that is signed by the investor, they do not reflect the investor's expectations or the reality of the situation.

Financial advisors know that investors do not scrutinize the documents that are put in front of them. They know their clients trust them, and they often exploit that trust by having their clients sign documents that do not accurately reflect their verbal agreements.

We regularly see clients who have signed documents they have not read and do not understand simply because their broker told them to sign them. For example, Paul and Ann invested their retirement funds of $250,000 with their broker who was also their neighbor. When the account was opened, the broker presented Paul and Ann with a stack of documents to sign. And of course, Paul and Ann signed everything their broker and neighbor put in front of them because he assured them the paperwork was just a formality. It turns out the documents were subscription agreements for private placements, and through the documents, Paul and Ann represented that they were sophisticated, wealthy, and had received and read all of the investment documents. They had done no such thing. Unfortunately, while the broker and the firm made substantial fees from these investments, Paul and Ann lost a significant amount of their retirement funds, and what they didn't lose was trapped in the illiquid investments.

Rather than allowing brokers to use technical agreements and contracts to limit their responsibilities to their clients, we must ensure that retirement investors receive the regulatory protections they rightfully expect. That's what the DOL is proposing to do, and why PIABA, on behalf of our members' clients, supports the DOL's efforts.