FINANCIAL SERVICES INSTITUTE
VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS AND INDEPENDENT FINANCIAL ADVISORS

VIA ELECTRONIC MAIL

February 29, 2016

Director William Beatty
Department of Financial Services Institutions, Securities Division
P.O. Box 9033
Olympia, WA 98507-9033

Re: Notice of Request for Comments Regarding Washington Department of Financial Institutions Proposed Verification Process for the Washington Small Business Retirement Marketplace

Dear Director Beatty:

On January 7, 2016, the Department of Financial Institutions (Department) introduced its proposed verification guidelines (Proposal) for financial firms to participate in the Washington Small Business Retirement Marketplace. Under Washington's proposal, separate verification is required for each retirement plan being included in the marketplace. Additionally, the proposal requires licensed financial services firms that are in good standing to offer plans with a minimum of "a target date or other similar fund, with asset allocations and maturities designed to coincide with the expected date of retirement; and a balanced fund."[1] Eligible plans must also allow enrollees to roll pretax contributions into different individual retirement accounts or other eligible retirement plans after they stop participating in an exchange offered plan. A provider cannot charge employers administrative fees and is limited to charging enrollees 100 basis points in total annual fees. Lastly, each firm must provide information about the plan's historical performance. The Financial Services Institute (FSI) appreciates the opportunity to comment on this important proposal.[2]

FSI's members are strongly committed to working with all stakeholders to battle our country's emerging retirement crisis. FSI commends Washington's determination to use a

[1] WAC 208-710-050 Application review criteria, *available at* http://dfi.wa.gov/documents/rulemaking/securities/small-business-retirement/proposed-rules.pdf.
[2] The Financial Services Institute (FSI) is an advocacy association comprised of members from the independent financial services industry, and is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has been working to create a healthier regulatory environment for these members so they can provide affordable, objective financial advice to hard-working Main Street Americans.

marketplace approach. However, FSI members have some concerns with the potential unintended consequences of certain aspects of the proposal. We elaborate on these concerns and provide suggested potential solutions in our comments below.

Background on FSI Members

The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the U.S., there are approximately 167,000 independent financial advisors, which account for approximately 64.5% producing registered representatives. These financial advisors are self-employed independent contractors, rather than employees of Independent Broker-Dealers (IBD).

FSI member firms provide business support to financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions. Independent financial advisors are small-business owners who typically have strong ties to their communities and know their clients personally. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations and retirement plans with financial education, planning, implementation, and investment monitoring. Due to their unique business model, FSI member firms and their affiliated financial advisors are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their investment goals.

Discussion

A. Introduction

The state of Washington is the first state to adopt a marketplace for private employees of small businesses to find affordable retirement plans. "[S]mall businesses, which employ more than forty percent of private sector employees in Washington, often choose not to offer retirement plans to employees due to concerns about costs, administrative burdens, and potential liability that they believe such plans would place on their business."[3] Washington's goal of the marketplace is clear -- to educate small employers on plan availability while also promoting participation in low-cost, low-burden retirement plans. The Department of Commerce will approve retirement plans for inclusion in the marketplace, provided that financial services firms offering retirement plans meet the Department's verification requirements laid out in this regulatory proposal. FSI supports Washington's purpose and goals for creating the Small Business Retirement Marketplace, but FSI points out important considerations Washington should take into account before finalizing these rules, to ensure that small business employees are able to maximize the benefits of this exchange.

B. FSI endorses the Washington Small Business Retirement Marketplace and applauds Washington for taking this approach.

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[3] SSB 5826 *available at* http://lawfilesext.leg.wa.gov/biennium/2015-16/Pdf/Amendments/Senate/5826-S%20AMS%20MULL%20S2596.2.pdf.

FSI wants to first commend Washington on its adoption of the marketplace approach as opposed to a secure choice plan,[4] prototype plan, or multiple employer plan approach. FSI believes that the marketplace approach provides the most options to small businesses while remaining efficient, thus better benefiting private employees. Additionally this approach is the most flexible option, allowing employers to maximize the potential benefits for their employees through employer contributions, which is prohibited under the secure choice model. Importantly this approach does not expose the state to huge unforeseen liability issues because of the state's clearly defined role of merely providing the exchange where private plans can be found as opposed to the state taking on the financial responsibility for retirement plans. Lastly, FSI wants to commend Washington on its clear commitment to creating retirement options and educating investors and their employers to ensure that everyone is better informed about their options for saving for retirement. FSI believes the state of Washington is serving as a model for other states to follow.

C. FSI requests that the Department create a supplemental application form, allowing independent advisors to send in one application for all applicable plans.

The Department's proposal requires verification applications to be submitted for each plan a financial services firm or independent advisor wants to include in the marketplace. While the proposed guidelines ensure that the Department is able to properly review and verify each potential plan before it is included, FSI is concerned that the requirement inadvertently places an undue burden on independent financial advisors. Independent advisors run their own small business and thus pay their own costs and employ their own employees. Because these advisors are independent they are able to offer a wide variety of products and plans. They are adept at tailoring their services to a wide variety of clients. Independent advisors are therefore able to service middle class Main Street investors. Because of their independent business structure, these financial advisors tend to work in smaller offices without the same administrative support as larger firms. Many of these advisors spend a significant amount of time on ensuring compliance while also serving their clients. Because of the important demands on their time and resources, independent advisors would need to take the time to apply for each plan to be included in the exchange, which FSI is concerned would be inefficient and may discourage advisors from applying altogether, thus resulting in a more limited group of options for investors.

FSI proposes that the Department consider amending their guidelines to also include a supplementary form that would allow an advisor to send in one application for all applicable plans and provide specific additional information through the supplement. This supplemental form could be submitted in addition to the current form, for instance as an addendum. This form could require the advisor to include information regarding the additional plans which would help streamline the verification process for the Department. This would allow independent financial advisors to participate in the exchange which would increase the options available to investors.

D. FSI requests that Washington consider increasing the fixed amount of fees to better reflect national averages for small business retirement plans.

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[4] The Secure choice model is a mandatory state-sponsored payroll deduction IRA program for private sector employees who are not currently offered a retirement plan.

The Department's current proposal states that firms may not charge administrative fees to employers. Additionally, firms may not charge enrollees more than 100 basis points for their plans. The Department understandably wants to limit fees to ensure that plans are affordable for small business employees and those employees are actually able to save. While FSI understands the need to create limitations on firms to meet the goal of the exchange, offering low cost retirement plans, we request that the amount be adjusted to more accurately reflect actual plan costs. FSI is concerned that by fixing fees at 100 basis points, financial services firms and independent advisors would be unable to provide viable options to small business employers therefore continuing to limit these employees' potential retirement options.

Participation numbers and account balances are the most accurate determinants of plan pricing. LIMRA (formerly known as the Life Insurance and Market Research Association), a worldwide research, consulting and professional development organization found that "average fees and expenses range between one to two percent, depending on the size of the plan (how many employees are covered) and the employees' allocation choices (i.e. index funds versus actively managed funds)."[5] Plans with more participants and larger average account balances tend to have lower all-in fees than plans with fewer participants and smaller average account balances. This effect results in part from fixed costs required to start up and run the plan, much of which are driven by legal and regulatory requirements. Additionally, economies of scale are gained as a plan grows because these fixed costs can be spread across more participants, a larger asset base, or both.

FSI requests the state of Washington to consider increasing the limit of enrollee fixed fees to 140 basis points, which we believe better reflects actual plan costs based on the following data. A 2011 study by the Center for American Progress Action Fund reported that plans with fewer than 100 participants have an average fee of 1.32 percent.[6] Demos, a non-partisan public policy research and advocacy organization in New York City, also reported that in 2011 "[t]he smallest plans, with 10 participants and an average account balance of $10,000 have an average expense ratio of over 1.4 percent, while the expense ratios of the largest plans average less than a third of that, less than 0.4 percent."[7] In 2012, "[l]ooking at the total plan expenses, including administrative and record-keeping fees, the 401(k) Averages Book found that the average total expense for a small plan in 2012 was 1.46%, with a range between a low of 0.38% and a high of 1.97%."[8] A 2013 study by Brightscope found that large plans (over $100 million) had an average total cost of 0.49%; medium sized plans ($10 million to $100 million) had an average total cost of 0.87%; and smaller plans (under $10 million) had an average total cost of 1.41%.[9] Additionally, Joe Valletta, author of *The 401k Averages Book*, pegs the range of plan fees to be

[5] Ashlea Ebeling, *401(k) Fees Still Widely Misunderstood*, FORBES, Mar. 11, 2013, 4:59PM, *available at* http://www.forbes.com/sites/ashleaebeling/2013/03/11/401k-fees-still-widely-misunderstood/#14dcb94f36f6.
[6] Jennifer Erickson and David Madland, *Fixing the Drain on Retirement Savings*, CENTER FOR AMERICAN PROGRESS, Apr. 11, 2014, *available at* https://www.americanprogress.org/issues/economy/report/2014/04/11/87503/fixing-the-drain-on-retirement-savings/.
[7] Robert Hiltonsmith, *The Retirement Savings Drain: The Hidden & Excessive Costs of 401(k)s*, DEMOS, *available at* http://www.demos.org/sites/default/files/publications/TheRetirementSavingsDrain-Final.pdf.
[8] Ashlea Ebeling, *401(k) Fees Still Widely Misunderstood*, FORBES, Mar. 11, 2013, 4:59PM,, *available at* http://www.forbes.com/sites/ashleaebeling/2013/03/11/401k-fees-still-widely-misunderstood/#14dcb94f36f6.
[9] Christoper Carosa, *What is an Appropriate Fee that a 401k Plan Should Pay?*, FIDUCIARYNEWS.COM, Aug. 6, 2013, 01:03AM, *available at* http://www.fiduciarynews.com/2013/08/what-is-an-appropriate-fee-that-a-401k-plan-should-pay/.

from 0.87% for larger plans to 1.56% for smaller plans.[10] A research report by BrightScope and the Investment Company Institute in 2014 found that 401(k) plans with more than $1 billion in assets had an average cost of 28 basis points while plans with less than $1 million in assets had an average cost of 164 basis points.[11] More recently, a New York Times article from 2015 stated that "[t]he vast majority of 401(k)'s with less than $1 million in total assets had costs that ranged somewhere from 0.68 percent to a scandalous 2.66 percent."[12] And a 2015 white paper by "Personal Capital found that average total fee percentages range from 1.06% (USAA) to 1.98% (Merrill Lynch)."[13] This data demonstrates that 140 basis points better reflects the actual cost of maintaining these plans.

The data demonstrates that for the last five years the average cost for retirement plans for accounts with assets of less than $1 million was roughly 150 basis points, making the actual average cost to plans higher than Washington's proposed limitation. We are concerned that the 100 basis point cap will discourage firms and advisors from applying to be part of the exchange, meaning private small business employees will not gain access to additional retirement savings options. FSI understands that the state of Washington wants to ensure that investors' funds are going to their retirement savings rather than fees. We agree that fees need to be kept low in order to ensure that enrollees are actually saving for retirement. Therefore, we believe that a 140 basis point limit will both better reflect the current marketplace and actual costs as well as protecting investors' hard earned assets.

Conclusion

We are committed to constructive engagement in the regulatory process and welcome the opportunity to work with the Department of Financial Institutions on this regulatory proposal and other important regulatory efforts. FSI believes that allowing a supplemental verification form to be filed for firms and advisors that want to include multiple plans along with increasing fee limitations will help create the proper framework to ensure that employees of small businesses have the best potential options available to them to save for retirement. We believe that increasing the cap on fees to 140 basis points better reflect their actual costs and will help ensure employees are able to have a wide variety of options.

FSI would also like to offer itself as a resource to the state of Washington to assist with its goal of active promotion of effective financial literacy. Washington clearly made this a priority when it included in the founding legislation creating the marketplace, the action to "promote the benefits of retirement savings and other information that promotes financial literacy."[14] FSI strongly believes in the importance and value of educated investors and has made the promotion of financial literacy one of its main advocacy goals. FSI believes financial literacy is an excellent area for regulators and the industry to work together toward a common goal.

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[10] *Id.*

[11] *The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans*, Dec. 2014, *available at* https://www.ici.org/pdf/ppr_14_dcplan_profile_401k.pdf.

[12] Tara Siegel Bernard, *Simpler, Less Expensive 401(k) Options Emerge for Small Businesses*, NYT, Sept. 11, 2015, *available at* http://www.nytimes.com/2015/09/12/your-money/401-k-options-for-small-businesses.html.

[13] *Financial Savings Report: The Real Cost of Fees*, PERSONAL CAPITAL, *available at* https://www.personalcapital.com/assets/whitepapers/PC_Fees_WhitePaper.pdf.

[14] S.B. 5826 *available at* http://app.leg.wa.gov/documents/billdocs/2015-16/Htm/Bills/Senate%20Passed%20Legislature/5826-S.PL.htm.

Thank you for considering FSI's comments. Should you have any questions, please contact me at (202) 803-6061.

Respectfully submitted,

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