# COBRA's Mother Takes on Wall Street in Fight Over 401(k)s

By Robert Schmidt - Jun 18, 2014

Phyllis Borzi spent decades helping invent ways to protect people from unpleasant surprises in their health and retirement plans. Never did she run into the kind of resistance finance firms have mustered against her latest idea.

And rarely has the industry met a bureaucrat so difficult to shut down.

Borzi, an assistant secretary at the U.S. Labor Department, has spent four years battling the full force of the financial lobby, interference from the White House and pressure from lawmakers of both parties over rules for individual retirement accounts and 401(k) plans.

She has long argued that people's retirement savings can be eroded by high fees or imprudent investments recommended by advisers with hidden incentives. She is pushing for brokers to be held to a legal standard that they must act in a client's best interest, an obligation known as a fiduciary duty.

Firms including Morgan Stanley and Fidelity Investments, which say the change would hurt, not help, small investors, appeared to have won the latest round last month. Yet neither side shows signs of backing away. In speeches, Borzi invokes the movie Groundhog Day, in which events are relived over and over. Financial lobbyists see it as a game of Whac-A-Mole. No matter how many times they pound her down, Borzi keeps popping up.

"She does not pander to the industry," said Barbara Roper, director of investor protection for the Consumer Federation of America, which backs Borzi's effort.

'Iron Fist'

Consumer advocates compare Borzi to Gary Gensler, the ex-U.S regulator who clashed with Wall Street as he tried to make private trading of derivatives more transparent. Roper said the comparison is apt -- up to a point.

Gensler's style "is more iron fist, velvet glove," Roper said. "Phyllis doesn't bother with the glove."

Industry groups say Borzi's efforts are misplaced, because if there are brokers who take advantage of clients, they're a tiny minority. The Securities and Exchange Commission, the states and self-regulatory organizations already police the industry for such conflicts, they add.

"There is no evidence of a crisis, no evidence of a problem," said Kenneth Bentsen, president of the Securities Industry and Financial Markets Association, known as Sifma, Wall Street's largest lobbying group.

'Happy Face'

The story of Borzi's quest shows how one individual in the government can drive a policy forward by dint of her own will and conviction. Yet her failure thus far is a lesson in what happens when that idea collides with longstanding business practices that involve trillions of dollars.

Borzi's most recent setback came late last month when the Labor Department quietly issued a notice postponing her proposal until January. It had been expected to be released in August. The move left her small band of supporters outside government wondering if their chances for success were waning.

"I don't know how you put a happy face on it," said Knut Rostad, a compliance officer at an investment advisory firm and founder of the Institute for the Fiduciary Standard. "If someone was going to be sober about it, they'd say we are running out of years."

Borzi (pronounced BOR-zhee) has been unusually silent since the delay, which comes after she was forced to withdraw her original fiduciary

regulation in 2011. Her spokesman Mike Trupo didn't respond to requests for an interview.

College Professor

A grey-haired lawyer recognizable by her large, round glasses, Borzi, 67, seems an unlikely antagonist of big banks and brokerages. She was a research professor at George Washington University's public health school before being named in 2009 by President Barack Obama to the Labor post that oversees private-sector benefit plans. She earned a master's in English from Syracuse University and her law degree from Catholic University in Washington.

While little-known outside of her field, Borzi's impact on the U.S. health and retirement systems has been profound. Along with her pension responsibilities at Labor she has been a point person on implementing the Affordable Care Act, Obama's health care law.

Many of Borzi's accomplishments came while she served for 16 years as pension and employee-benefits counsel for a U.S. House subcommittee. She's known as the "mother of COBRA" for her work on that law, which allows workers who lose their jobs to temporarily extend their health coverage. She also proudly cites her authorship of a law giving women more rights to their husbands' pensions in the case of an early death or divorce.

Turning 65

How Americans save for their latter years has changed vastly since Labor first set rules for retirement funds in the 1970s. Many workers had employer-controlled pensions and the 401(k) didn't exist. Now, pensions are rare and tens of millions of people rely on their 401(k) plans and IRAs, which together hold almost $11 trillion.

Those resources are increasingly needed. Some 10,000 people will turn 65 every day from now until Dec. 31, 2030, Borzi pointed out in a March speech to the Financial Services Roundtable, an industry trade association that opposes her plan. She told the group the fiduciary standard is a "critically important" consumer protection.

"People who hold themselves out as experts, who cultivate a relationship of trust with clients, need to put their money where their mouths are," she said. "They need to actually put the clients' interest first."

Chamber Lobbying

Borzi's opponents are Wall Street banks with brokerages, mutual fund companies that thrive on clients who roll their 401(k) plans into IRAs, insurers selling annuities, and independent brokers and financial planners. Besides Fidelity and Morgan Stanley (MS), they include Bank of America Corp., UBS AG (UBSN) and Ameriprise Financial Inc. (AMP), along with finance trade groups, the U.S. Chamber of Commerce and American Council of Life Insurers.

The industry contends Borzi's change would throw the system into chaos by making it too expensive for financial firms to manage most retirement accounts.

Typically, customers can turn to one of two kinds of investment professionals: brokers, who generally offer limited advice and are paid a commission on each trade; and investment advisers, who provide more personalized counsel and charge an annual flat fee based on the size of a client's portfolio. Both are regulated by the SEC, though when dealing with retirement accounts they fall under Labor's purview.

'Suitable' Standard

Brokers are held to a "suitability" standard, meaning they must reasonably believe their recommendation is right for a client. Investment advisers operate under the fiduciary standard, which imposes a much tougher overall responsibility for the customer's welfare.

One rationale for changing the rules is that it would be easier for investors to expect the same treatment no matter who they deal with. Brokers, though, say that if they became fiduciaries it would create more paperwork and a higher risk of lawsuits from displeased customers, raising costs so much they'd be forced to switch clients into advisory accounts.

That model, the industry argues, isn't economical with smaller accounts -- those with balances under $50,000. Those investors would likely be forced to handle savings on their own, sorting through options online without professional help.

"We don't want to price modest-income people out of the market of getting advice," said Tim Pawlenty, president of the Roundtable.

Undercover Probe

A 2011 study by the SEC's staff, mandated by the Dodd-Frank law, noted "robust recent evidence that many retail investors do not understand or are confused by the different standards of care applicable to investment advisers and broker-dealers." Outside of the Labor process, the SEC is also considering whether to have a fiduciary standard for brokers.

The Government Accountability Office last year decided to test how frequently salespeople for financial firms provide misleading advice. It had an investigator pose as a customer asking how to handle a 401(k) account after leaving his job.

After checking with 30 firms that administer the accounts, the GAO determined that investors were often given incomplete or incorrect guidance that steered them to convert their 401(k) into an IRA run by the same company, a move that could lead to higher fees and less protection. The report, released in April 2013, urged Labor to complete its fiduciary rule and require that brokers and other salespeople disclose conflicts of interest "in a clear, consistent and prominent manner."

Lawmaker Letters

Borzi first published her plan in late 2010, about a year after she became Labor's assistant secretary for the Employee Benefits Security Administration.

The backlash was swift. Wall Street's biggest lobbying groups, including the Roundtable and Sifma, fanned out on Capitol Hill, asking Democrats and Republicans to send letters to Labor and the White House. They complained to lawmakers that Borzi had leapt into the fray without properly consulting with other regulators or the industry.

Borzi was summoned to a hearing before a House Education and the Workforce subcommittee, where lawmakers from both parties echoed industry concerns. They complained about her lack of coordination with the SEC. Representative Joe Heck, a Nevada Republican, told Borzi he was hearing from many brokers in his district who said they'd be unable to charge commissions.

Frank Note

Ultimately, more than 200 lawmakers weighed in with letters to Labor -- including one of the authors of Dodd-Frank, then Democratic Representative Barney Frank of Massachusetts, who wrote to "strongly urge" the department to withdraw and revise its rule.

The Financial Services Institute, a trade group that represents independent broker-dealers and financial advisers around the country, got 7,000 members to fax personal letters to the White House opposing the rule.

According to two people who worked on the issue and spoke on condition of anonymity, the Roundtable contacted Wall Street Journal editorial writers. The newspaper published a piece in August 2011 citing industry-funded research that found the fiduciary rule could cut off 7 million IRAs from meaningful investment services.

"Someone from the White House needs to step in here before Ms. Borzi's savings bomb falls on the heads of American investors," the editorial concluded.

Economic Council

The White House did step in, according to people who lobbied on both sides of the issue. The industry had worked through Obama's National Economic Council, arguing to its director, Gene Sperling, that the Labor Department was creating a regulatory morass, said three people who attended meetings with the council.

Sperling, who left the post in March, said in an interview that while the economic team "has always taken a clear position that there are

some real conflict-of-interest problems" in the broker-client relationship, "we felt it was important to make sure any steps were balanced, well-targeted and reasonably coordinated."

The White House's concerns were conveyed to the leadership at the Labor Department, according to a person who worked on the issue for the government.

That September, Labor issued a press release saying it was withdrawing the regulation and would re-propose it in "early 2012."

'More Input'

The decision, according to the statement, was "in part a response to requests from the public, including members of Congress, that the agency allow an opportunity for more input on the rule."

Since then, the Labor Department has kept pushing back the date for the new version of the rule. In late 2013, it put out a schedule setting the release for August 2014. Early this year, Borzi contacted outside supporters as she sought to build momentum on Capitol Hill, according to two people who participated in a conference call with her. Among groups active on the issue were AARP, the AFL-CIO and the consumer federation.

Again, the industry counter-attacked. Lobbyists raised the specter of the upcoming mid-term elections to force another delay, people familiar with the matter said.

Sifma and other trade groups recently contacted about 40 members of the House and Senate, many in tight races, and suggested they ask the Obama administration to postpone the rule until after the November elections, according to one person familiar with the strategy. The message, the person said, was that it was a bad time to hurt mom-and-pop investors still struggling in the wake of the financial crisis.

Shifting Donations

Brian Graff, head of the National Association of Plan Advisors, whose members serve employer-sponsored retirement plans, said that prime targets included Senators Kay Hagan of North Carolina and Mark Pryor of Arkansas, two Democrats "who don't want another issue that could be used by their opponents."

Political donations were a part of the effort. The Financial Services Institute rebalanced its giving toward Democrats, reversing its usual Republican tilt. The group also focused on the Congressional Black Caucus, making a contribution to Maxine Waters, the ranking Democrat on the Financial Services Committee, and seven other members of the group. All had signed letters to Labor opposing the rule.

Soothing Tweaks

The industry also took its arguments to Labor Secretary Thomas E. Perez, who in public comments had been supportive of Borzi's effort. Sifma and other groups circulated a study from the U.S. Hispanic Chamber of Commerce in May that said almost half of the small business owners it polled would cut back employee matches or raise fees for their retirement programs if the definition of fiduciary duty were expanded.

The survey was co-sponsored by law firm Davis & Harman LLP, which said it was commissioned "on behalf of a coalition of financial services organizations that provide retirement services to millions of Americans."

Xochitl Hinojosa, a spokeswoman for Perez, didn't respond to requests for comment.

When the Labor rule is finally proposed, the new version will have tweaks designed to soothe some industry concerns, Borzi has said.

Few expect the changes to end the long dispute.

"There is a high level of expectation that come next year, this will be a battle," Graff said.

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