

July 21, 2015

Office of Exemption Determinations  
Employee Benefits Security Administration  
Attention: D-11712  
U.S. Department of Labor  
200 Constitution Avenue NW  
Washington, DC 20210

RE: Conflict of Interest Rule—Retirement Investment Advice RIN 1210-AB32  
Proposed Best Interest Contract Exemption ZRIN: 1210-ZA25; Docket ID EBSA-2014-0016

Dear Secretary Perez:

This comment is submitted by the Center for American Progress, or CAP, a progressive, nonpartisan think tank dedicated to improving the lives of Americans through ideas and action. As part of its efforts to reduce poverty and ensure a stable middle class, CAP promotes policies to improve the financial well-being of low- and moderate-income households and promote a financial system that works for everyone.

CAP appreciates the opportunity to comment on the Department of Labor's proposed conflict of interest rule. Overall, CAP commends the Department of Labor's proposed rule and supports the Department's intent to close loopholes, reduce ambiguity, and improve investor confidence in the often-confusing process of receiving retirement advice.

CAP also supports the Best Interest Contract Exemption as a means to improve transparency and accountability for retirement investments through broker-dealers, as well as the proposed Low-Fee Streamlined Exemption provided that it is sufficiently narrow to truly reflect low-cost investment options.

In addition, CAP recommends that the Department of Labor take the following additional steps to improve the financial security of workers and retirees:

- Strengthen disclosures under the Best Interest Contract Exemption and extend them to all retirement savings products.
- Restrict the use of mandatory arbitration clauses to ensure that investors' rights are maintained.
- Extend the proposed IRA protections to other tax-advantaged savings vehicles such as Health Savings Accounts and education savings so financial professionals are not encouraged to sell other products merely to circumvent the rule.

### **Americans Increasingly Face Retirement Insecurity and Anxiety**

The environment in which Americans save for retirement has changed dramatically in the four decades since the current ERISA fiduciary rule was established in 1975. At that time, nearly three-quarters of all retirement plan participants participated in a defined-benefit retirement plan through their employer,<sup>1</sup> and individual retirement accounts, or IRAs, had just been established.<sup>2</sup> Yet the vast majority of retirement plan participants today are in defined-contribution plans, such as 401(k)s, rather than a defined-benefit plan.<sup>3</sup> Today, assets in IRAs even exceed those in 401(k) plans; according to the

Investment Company Institute, \$7.4 trillion in retirement assets were held in IRAs in 2014, compared to \$6.8 trillion in defined-contribution plans such as 401(k)s.<sup>4</sup> As a result, the vast majority of retirement savings now lies in accounts where individual investors and retirees are responsible for making decisions about saving, investing, and ensuring that their nest eggs will last a lifetime.

Many workers in this environment are inadequately prepared for retirement. The median retirement account balance of all households age 55-64 with retirement plans is only \$105,000, and if including households with no retirement accounts at all, it is a mere \$14,500.<sup>5</sup> The share of working-age households inadequately prepared for retirement grew from approximately 31 percent in 1983 to 52 percent in 2013, according to the Center for Retirement Research at Boston College's National Retirement Risk Index.<sup>6</sup> Some demographic subgroups, such as African-American and Latino households, households without a high school diploma or GED, and households headed by single women, face an even higher likelihood of insufficient retirement savings.<sup>7</sup>

### **Retirement Investors Face Conflicted Advice, Resulting in Additional Costs and Risk**

Given these challenges, savers and retirees often look to financial professionals to help them determine the best possible outcomes to achieve financial security. When they do, they encounter numerous and confusing designations of financial expertise in the marketplace.<sup>8</sup>

It is particularly challenging for consumers to understand their financial professional's obligations toward them. While registered investment advisers are subject to a "fiduciary" standard, which requires that they recommend products that are in their client's best interest, not all financial professionals are currently held to this standard, instead meeting only a "suitability" standard. This "suitability" standard that currently applies to many broker-dealers and others was established in an era where few Americans were tasked with managing their own retirement assets and provides excessive leeway to brokers who market themselves with titles such as "financial adviser" or "financial consultant" without actually complying with the rules that should govern binding relationships of trust.

"Suitability" is the product of multiple loopholes in the 1975 regulation of conflicted advice, which subjected potential fiduciary activities to a five-point test, including advice given "on a regular basis" and "pursuant to a mutual agreement, arrangement, or understanding" that the advice is the "primary basis" of an investment decision. While one-time provision of retirement advice does not constitute advice "on a regular basis," that advice may have significant long-term financial consequences, such as the purchase of an annuity. Similarly, the "mutual agreement" and "primary basis" loopholes enable financial professionals to use the fine print of contracts to evade a fiduciary standard. Overall, the current "suitability" standard enables financial professionals to steer customers to products that are in their own self-interest, rather than in the best interest of their clients.

High fees are one consequence of this conflict between the best interests of the financial professional and its client, which can significantly diminish the adequacy of retirement savings. As noted in a 2014 Center for American Progress report, even a 75 basis point, or 0.75 percent, difference in fees between a high-cost and low-cost investment option for a young worker results in \$100,000 of additional fees across a lifetime, equivalent to an additional three years of work to achieve the same level of retirement security.<sup>9</sup> A 105 basis point, or 1.05 percent, difference in fees results in paying \$124,000 more in fees over a lifetime.<sup>10</sup> Considering that these compounding effects by themselves are even greater than the total savings of many near-retirees, there is a compelling need to reduce the magnitude of unnecessary fees in the retirement savings marketplace.

Conflicted advice may also lead to inappropriate rollover decisions. The vast majority of IRA funds come from rollovers; in 2012, 87 percent of traditional IRAs were opened with rollover dollars.<sup>11</sup> Yet many of these rollovers may have been expensive or unnecessary. As evidenced by the Government Accountability Office's recent study of 401(k) rollovers, savers frequently shift from low-fee 401(k)s to high-fee IRAs when they change jobs as a result of inappropriate and often conflicted advice that rewards financial firms and advisers.<sup>12</sup> Indeed, as the Government Accountability Office has noted, financial services firms' call centers will "highly encourage" 401(k) participants to convert their funds to an IRA even if they could just as easily keep funds in their existing plan, which may have lower fees, or roll them over to the new employer's plan.<sup>13</sup>

The ramifications of these decisions, however, often go beyond the imposition of higher fees than necessary. The case of Elaine and Merlin Toffel of Illinois, as reported last year in the *New York Times*, is instructive. After meeting with investment brokers at their local bank branch in search of retirement advice, they sold a portfolio of low-cost investments—incurring tax consequences along the way—and invested most of their money in expensive variable annuities recommended by the bank, with a 4 percent annual fee and a 7 percent surrender fee for accessing funds early.<sup>14</sup> The surrender fee made it difficult to use these assets to cover long-term care expenses. An advisor acting in the Toffels' best interest likely would have identified modest changes to their investments that would serve their needs rather than an expensive and risky annuity product.

### **The Proposed Rule Closes Significant Loopholes**

The Department of Labor's proposed rule closes these loopholes by establishing a fiduciary duty for investment advice in both employee benefit plans and IRAs, a significant step given that the volume of IRA assets will likely grow as Baby Boomers retire. The proposed fiduciary standard is comprehensive, applying to a wide range of fees and both direct and indirect compensation, including brokerage fees, mutual fund sales, and insurance sales commissions.

Additionally, the rule would apply to all cases of "individualized" or "specifically directed" advice, including the types of activities, such as one-time advice, under which brokers are generally able to use loopholes to evade the standard. Ultimately, the proposed rule would bring the costs of financial advice into the spotlight rather than allowing them to remain hidden within the fine print of the financial products that are offered to consumers.

Activities that are general in nature or do not reflect an advice-giving relationship are appropriately exempt from the proposed rule. The rule includes a carve-out for generalized, non-fiduciary investment or retirement education, such as workshops that provide general information about retirement planning strategies, as well as carve-outs for order-taking by broker-dealers and certain activities by employees of a plan sponsor or investment platform who are not making specific investment recommendations.

We do not have a concern that a fiduciary standard will punish "small savers." The financial industry routinely warns about constrained access when efforts are made to restrict predatory or misleading credit products, such as high-cost mortgages, auto loans at inflated rates, and payday loans that the borrower is unlikely to pay back.<sup>15</sup> Yet just as we do not want consumers to purchase excessively high-cost and risky products, we do not want consumers to receive high-cost, risky retirement advice.

## **The Proposed Best Interest Contract Exemption and Low-Fee Streamlined Exemption Expand Transparency and Accountability**

Through the Best Interest Contract Exemption, or BICE, the proposed rule provides a roadmap for broker-dealers and others to be accountable to consumers without fundamentally changing their compensation mechanisms. Under the BICE, advisors would enter into a written, enforceable contract with investors that acknowledges the fiduciary nature of the advice that is given and demonstrates standards of impartial conduct that place the investor's best interest first. Advisors would also disclose basic information on costs and conflicts of interest.

The proposed BICE disclosures -- a pre-purchase transaction disclosure, an annual disclosure, and summary compensation data by asset on the financial institution's web page -- must contain data summarizing all direct and indirect compensation by asset. These disclosures will enable investors and the general public to better understand and compare plan fees. CAP has supported similar disclosure tools across the spectrum of 401(k)s and IRAs that identify potentially obscure or hidden fees.<sup>16</sup> However, to ensure that these disclosures are relevant, they should reflect the actual costs associated with a financial product, not the generic "cigarette warning-style" messages suggested as an alternative in the proposed rule. Additionally, these fee disclosures, while important, are no substitute for the enforceable consumer protections also provided under this exemption.

If properly designed and implemented, the proposed Low-Fee Streamlined exemption is also a sound approach to dealing with the challenge posed by fees as long as it encompasses only the lowest-fee products available, such as the top five or ten percent of mutual funds in the marketplace. While we recognize the Department's interest in making available a wide range of investment options, we urge that this exemption recognize the significant cost savings of passively-managed funds that generate comparable or even better returns to savers than their actively-managed counterparts.<sup>17</sup>

### **Additional Recommendations to Strengthen the Rule**

- 1. Strengthen disclosures under the Best Interest Contract Exemption, and extend them to all retirement savings products.** The BICE disclosures could be strengthened by incorporating recent best practices that CAP has proposed. First, given the effects of compounding and the challenge of comparing costs across various assets and account balances, the pre-purchase transaction disclosure should also contain a "20/20" disclosure: the effect of fees on a \$20,000 initial investment over a 20-year period.<sup>18</sup> This would provide a single point of comparison from one investment to another. Second, since the proposed rule does not contain an illustration of the annual disclosure, the Department should consider the format of an annual retirement receipt<sup>19</sup> that indicates the percentage and dollar amount of fees by fund in addition to compensation received. These forms of pre-purchase and annual disclosures should ultimately be required for all retirement savings vehicles such as 401(k)s and IRAs, even beyond the scope of this rule.
- 2. End forced arbitration in retirement investment advice contracts.** While the proposed rule reaffirms the right of retirement investors to pursue class actions against investment advisers when they fail to meet their fiduciary obligations for a wide group of consumers, it still permits pre-dispute binding arbitration clauses to be used when an individual consumer is wronged. Most claims will likely be individual ones, and most consumers will likely end up in arbitration. As the Consumer Financial Protection Bureau recently noted, the overwhelming majority of consumers are not aware

of the binding arbitration clauses in their contract that limit consumers' rights in court and that these clauses limit relief for consumers.<sup>20</sup>

- 3. Extend the proposed IRA protections to other tax-advantaged savings vehicles.** The proposed rule asks whether Health Savings Accounts, or HSAs, and other tax-advantaged savings vehicles, including education savings, should be subject to the same fiduciary standard that would govern IRAs. According to the Investment Company Institute, assets in 529 college savings plans exceeded \$224 billion in 2014.<sup>21</sup> Investment advisor Devenir anticipates that the HSA market will exceed \$40 billion in assets by 2017.<sup>22</sup> Given the interest in protecting savers and minimizing the fees levied on tax-advantaged accounts, these savings vehicles should also be subject to the same fiduciary duty rules that would apply to IRAs. Otherwise, brokers and other financial professionals could potentially be tempted to steer investors toward these products in the absence of limitations on conflicted advice, thereby opening a new loophole even as the IRA loopholes close.

## Conclusion

The Department of Labor's proposed rule reflects a balanced approach to the decades-old problem of conflicted retirement advice that results in retirement savers and retirees paying too much and receiving too little. Strengthening the disclosures in the Best Interest Contract Exemption and extending them to all retirement savers, crafting a narrow low-cost investment exemption, ending the use of forced arbitration clauses, and expanding the proposed IRA protections to other tax-advantaged savings vehicles would further strengthen the rule as well as Americans' overall retirement security.

Thank you again for the opportunity to comment on this proposed rule. If you would like to discuss anything in this letter in more detail, please contact Joe Valenti, Director of Consumer Finance, at [jvalenti@americanprogress.org](mailto:jvalenti@americanprogress.org).

Sincerely,

Center for American Progress

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<sup>1</sup> Center for American Progress tabulations of Table E5, "Number of Participants in Pension Plans by type of plan, 1975-2012," in "Private Pension Plan Bulletin Historical Tables and Graphs," Employee Benefits Security Administration, U.S. Department of Labor, December 2014, available at <https://www.dol.gov/ebsa/pdf/historicaltables.pdf>. These tabulations likely understate the magnitude of the shift toward defined-contribution plans because the statistics double-count individuals who participate in both types of plans.

<sup>2</sup> Sarah Holden and others, "The Individual Retirement Account at Age 30: A Retrospective," Investment Company Institute *Perspective*, Volume 11 No. 1, February 2005, available at <https://www.ici.org/pdf/per11-01.pdf>.

<sup>3</sup> Center for American Progress tabulations of Table E5, "Number of Participants in Pension Plans by type of plan, 1975-2012."

<sup>4</sup> Investment Company Institute, "2015 Investment Company Fact Book" (2015), available at [https://www.ici.org/pdf/2015\\_factbook.pdf](https://www.ici.org/pdf/2015_factbook.pdf).

<sup>5</sup> Keith Miller, David Madland, and Christian E. Weller, "The Reality of the Retirement Crisis" (Washington: Center for American Progress, 2015), available at <https://www.americanprogress.org/issues/economy/report/2015/01/26/105394/the-reality-of-the-retirement-crisis/>.

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<sup>6</sup> Alicia H. Munnell, Wenliang Hou, and Anthony Webb, “NRRI Update Shows Half Still Falling Short,” Center for Retirement Research at Boston College, No. 14-20, December 2014, available at [http://crr.bc.edu/wp-content/uploads/2014/12/IB\\_14-20-508.pdf](http://crr.bc.edu/wp-content/uploads/2014/12/IB_14-20-508.pdf).

<sup>7</sup> Christian E. Weller and David Madland, “Keep Calm and Muddle Through: Ignoring the Retirement Crisis Leaves Middle-Class Americans with Little Economic Control in Their Golden Years” (Washington: Center for American Progress, 2014), available at <https://www.americanprogress.org/issues/economy/report/2014/08/06/95222/keep-calm-and-muddle-through/>.

<sup>8</sup> Consumer Financial Protection Bureau, “Senior Designations for Financial Advisors: Reducing Consumer Confusion and Risks,” April 18, 2013, available at [http://files.consumerfinance.gov/f/201304\\_CFPB\\_OlderAmericans\\_Report.pdf](http://files.consumerfinance.gov/f/201304_CFPB_OlderAmericans_Report.pdf).

<sup>9</sup> Jennifer Erickson and David Madland, “Fixing the Drain on Retirement Savings: How Retirement Fees Are Straining the Middle Class and What We Can Do about Them” (Washington: Center for American Progress, 2014), available at <https://www.americanprogress.org/issues/economy/report/2014/04/11/87503/fixing-the-drain-on-retirement-savings/>.

<sup>10</sup> Ibid.

<sup>11</sup> Ibid.

<sup>12</sup> Government Accountability Office, “401(k) Plans: Labor and IRS Could Improve the Rollover Process for Participants,” GAO-13-30, Report to Congressional Requesters, April 2013, available at <http://www.gao.gov/assets/660/652881.pdf>.

<sup>13</sup> Ibid.

<sup>14</sup> Tara Siegel Bernard, “Before the Advice, Check Out the Adviser,” *New York Times*, October 10, 2014, available at <http://www.nytimes.com/2014/10/12/business/mutfund/before-the-advice-check-out-the-adviser.html>.

<sup>15</sup> Joe Valenti, Sarah Edelman, and Julia Gordon, “Lending for Success” (Washington: Center for American Progress, 2015), available at <https://www.americanprogress.org/issues/economy/report/2015/07/13/117020/lending-for-success/>.

<sup>16</sup> Erickson and Madland, “Fixing the Drain on Retirement Savings: How Retirement Fees Are Straining the Middle Class and What We Can Do about Them”; Jennifer Erickson and David Madland, “Retirement Labels and Retirement Receipts Could Save American Investors Billions Each Year,” (Washington: Center for American Progress, 2015), available at <https://www.americanprogress.org/issues/economy/news/2015/07/01/115509/retirement-labels-and-retirement-receipts-could-save-american-investors-billions-each-year/>.

<sup>17</sup> Erickson and Madland, “Fixing the Drain on Retirement Savings: How Retirement Fees Are Straining the Middle Class and What We Can Do about Them.”

<sup>18</sup> Ibid.

<sup>19</sup> Jennifer Erickson and David Madland, “Retirement Labels and Retirement Receipts Could Save American Investors Billions Each Year.”

<sup>20</sup> <http://www.consumerfinance.gov/newsroom/cfpb-study-finds-that-arbitration-agreements-limit-relief-for-consumers/>

<sup>21</sup> Investment Company Institute, “2015 Investment Company Fact Book.”

<sup>22</sup> Devenir Research, “2014 Year-End HAS Market Statistics & Trends: Executive Summary,” February 11, 2015, available at <http://www.devenir.com/devenirWP/wp-content/uploads/2014-Year-End-Devenir-HSA-Market-Research-Report-Executive-Summary.pdf>.