

Phyllis Borzi, Assistant Secretary  
Employee Benefits Security Administration  
Office of Regulations and Interpretations  
U.S. Department of Labor  
200 Constitution Avenue, NW  
Room N-5655  
Washington, DC 20210

**Re: Definition of the Term “Fiduciary;” Conflict of Interest Rule –  
Retirement Investment Advice  
RIN 1210-AB32**

Dear Assistant Secretary Borzi:

Sammons Financial Group (“**SFG**”), on behalf of itself and its subsidiary companies, is pleased to provide these comments with respect to the Department of Labor’s notice of proposed rulemaking concerning the definition of the term “fiduciary” in the context of an employee benefit plan and the related proposed new exemptions and exemption modifications.

SFG is a financial services holding company made up of member companies that offer a variety of investments and retirement services through multiple distribution channels. Our member companies potentially impacted by the proposed rulemaking include Midland National Life Insurance Company, North American Company for Life and Health Insurance, Sammons Retirement Solutions, Inc. (“**SRS**”) and Sammons Financial Network, LLC (“**SFN**”).

The Department of Labor (the “**Department**”) has recently re-proposed a package of changes to relevant regulations, new exemptive relief and changes to published exemptions (the “**Proposal**”) focused on re-defining who would be a fiduciary of an employee benefit plan under the Employee Retirement Income Security Act of 1974 (“**ERISA**”) as a result of giving investment advice to the plan or its participants or beneficiaries. Among other changes, the Proposal expands the scope of who would be an investment advice fiduciary under section 4975 of the Internal Revenue Code of 1986, as amended (“**Code**”), to include certain advisors to an individual retirement account (“**IRA**”).

We applaud the Department’s efforts to strengthen the standard of care for investment professionals serving clients participating in retirement plans and IRAs. The vast majority of the financial services industry serves its clients well by helping them

save more, grow their retirement savings and better understand the retirement financial landscape based on their individual facts and circumstances. The Proposal contains a number of provisions that may enhance investor protections. SFG's concerns regarding this Proposal are that in an effort to prevent potentially bad behavior by a few individuals, the Proposal will have various unintended consequences detrimental to many retirement clients.

## **SUMMARY**

- **Platform Provider Carve-out for IRAs**
  - ***The platform provider carve-out should be expanded to include IRA platform providers.*** The necessary protections exist, devoid of conflicts. A third-party fiduciary assists the IRA investor. The investment options are diversified and well-chosen.
  - ***Platform providers for IRAs do not make "recommendations."*** The IRA platform provider does not have retail client sales relationships that should be the focus of any standard of care.
  - ***Assistance provided by platform providers for IRAs is neither "individualized" for recipients, nor "specifically directed" to recipients.*** The IRA platform provider cannot have the knowledge of the circumstances of an IRA investor needed to become an investment advice fiduciary.
- ***New Impartial Conduct Standards in revised PTE 84-24 should be clarified to enhance its usefulness.*** Being admonished only to act in the "Best Interest" of an IRA investor and to not mislead such an investor circumscribes the relief provided by 84-24 without clearly conveying how conduct should change.
- ***Maintain the level playing field between commission-based compensation (that is in the best interests of the client) and fee-based arrangements.*** Significantly disadvantaging commission-based arrangements increases costs to IRA investors, greatly reduces available investment professionals and investment choices, and decreases access to retirement education, particularly for small, middle income IRA investors. The onerous conditions in the Proposal should be harmonized with the current regulatory schemes. The timing and form of any written contract should be reconsidered.

## **PLATFORM PROVIDER CARVE-OUT FOR IRAS**

The platform provider carve-out in proposed Labor Regulations section 2510.3-21(b)(3) (the "**Platform Carve-out**") is limited by its terms to a "person [who] merely markets and makes available to an employee benefit plan" a qualifying platform or similar mechanism from which a plan fiduciary can select and monitor investment alternatives. For the following reasons, the Platform Carve-out should be extended to include certain platform providers to IRAs with full confidence that the interests of IRA investors will be protected as contemplated by the Proposal.

### **Characteristics of IRA Carve-out Providers**

Platform providers to IRA investors ("**IRA platform providers**") are not uniform in their design or operation. IRA platform providers with the following characteristics provide, in conjunction with investment professionals who will be investment advice fiduciaries under the Proposal, a variety of protections for IRA investors that are at least commensurate with (if not superior to) the protections provided to participants and beneficiaries under a plan whose provider would be able to use the Proposal's Platform Carve-out. These important characteristics are:

- The platform would provide only a menu of pre-selected investments (e.g., certain mutual funds) as investment options.
- The IRA platform's investment options would be well-diversified. The IRA platform provider would include investments on the platform using various factors, including, but not limited to, the following: comprehensive ongoing coverage of important asset classes, multiple quality options in each important asset class, investment strategy, manager history and tenure, performance against selected benchmarks, type of securities being offered, class of security being offered, fees charged by the investment option's manager and service providers, and geographic location of the securities' issuers.
- The platform would make available a wide variety of investment options and managers. The platform must offer investments from many sources, not merely those sponsored by the platform's provider.
- No person affiliated with the platform would be involved in recommending investments to an IRA investor. Investments included on the platform would be among those reviewed and potentially recommended by an unaffiliated third party investment professional to specific IRA investors.
- The IRA platform provider and its platform would not have any sales relationships with IRA investors. There would be no sales contracts between an IRA investor and the IRA platform or its provider. The provider would never sign-off on investor suitability or appropriateness. For investment recommendations and

sales, the IRA investor relationship would be between the investment professional and the IRA investor.

- The IRA platform provider would have a contract with the IRA investor only to provide administrative services required to maintain the IRA (e.g., trade confirmations and annual statements). The IRA platform provider would receive a fee directly from the IRA investor or the IRA for these administrative services. All of these administrative fees would be unrelated to the investment decisions by the IRA investor.
- The IRA platform provider and the platform would not be affiliated with the investment professional making investment recommendations to an IRA investor, other than through an IRA platform contract giving the investment professional access to the IRA platform.
- The IRA platform provider would pay the unaffiliated investment professional a flat percentage of the dollar value of the assets invested by all of the investment professional's clients in the investment options offered on the platform. The investment professional's compensation from the IRA platform provider would not differ based on any individual IRA investor or specific investment.
- The IRA platform provider would receive no compensation from the investment professional.
- The IRA platform would not generate any sales or promotional materials promoting any investment offered on the platform over another.
- The IRA platform would not unilaterally prepare any recommendations made by an unaffiliated investment professional to an IRA investor. During the sales process, it would have no personal information about any IRA investor or about the individualized needs of any IRA investor. Using information provided by an investment professional, it may provide limited, clerical assistance to the investment professional preparing a recommendation (such as information regarding historical returns and portfolio characteristics of the investment options offered on the platform), but it would never create its own portfolio recommendation. Model allocations generated by an unrelated third-party investment advisor could also be available to the investment professional through the platform.
- The IRA platform provider would disclose to both the investment professional and through the investment professional, to the IRA investor that it is not offering investment advice by making the platform investment alternatives available, it is not a fiduciary as a result of providing the platform, and the platform has not been designed or operated with any single IRA investor or relationship in mind.

An IRA platform provider meeting the criteria described above (an "**IRA Carve-out Provider**") should not be an investment advice fiduciary for a number of reasons, some of which are discussed later. Most importantly, there is no apparent conflict of interest that would taint the platform. The IRA Carve-out Provider has wholesaled the platform to unaffiliated investment professionals. There is no retail sales relationship or responsibility to IRA investors. The unaffiliated investment professional, inevitably an investment advice fiduciary under the Proposal, would be functionally equivalent to a plan fiduciary under the Platform Carve-out. The investment professional would narrow the available platform options for the IRA investor and make such recommendations as it considers appropriate in its fiduciary role. With this structure, there is no perceptible deviation from the protections offered the client by the Proposal's Platform Carve-out that would justify denying the same relief to an IRA Carve-out Provider.

Investment advice fiduciaries for IRA investors must have access to coordinated investment offerings in order to serve their clients. Independent IRA Carve-out Providers are that source for IRA fiduciaries in many situations. IRA Carve-out Providers need to be encouraged, not discouraged. Imposing fiduciary status on mere IRA Carve-out Providers would reduce client investment options, weaken investment decisions and prevent clients from seeking the advice they should get, all to avoid conflicts that are for carve-out providers only a mirage.

The "IRA Carve-out Provider" is not a hypothetical. SFG, acting through SRS as an administrator and offering investment options through SFN, would qualify as an IRA Carve-out Provider under this proposal. SFG asks that the Platform Carve-out in proposed Labor Regulations section 2510.3-21(b)(3) be expanded to add a new Section 2510.3-21(b)(3)(ii) to expressly include another Platform Carve-out for an IRA Carve-out Provider to unaffiliated investment professionals for use with IRA investors.

### **IRA Carve-out Providers Do Not Give Recommendations, and the Proposal Should Reflect That.**

Under proposed Labor Regulations section 2510.3-21(a)(1), an investment advice fiduciary has to be a person rendering investment advice by giving a "recommendation" concerning (i) the "advisability of acquiring, holding, disposing or exchanging...property," (ii) the "management of...property," or (iii) "a person who will receive...compensation for providing [the preceding two] types of advice."

An IRA Carve-out Provider does not provide even a suggestion in any of those areas, and the Proposal should be modified to recognize that reality.

An IRA Carve-out Provider is not involved - even indirectly - in any sales relationship with the IRA investor. The relationship exists between the unaffiliated investment professional providing the advice and the IRA investor. The IRA Carve-out Provider will not independently know the identity, characteristics or needs of any prospective IRA investor or the pre-existing investments owned by the IRA investor in

retirement plans or other IRAs. As a result, the IRA Carve-out Provider cannot, even indirectly, comment on whether the IRA investor should or should not acquire, hold or sell any investment, much less one on its platform. The IRA Carve-out Provider:

- does not recommend an investment professional to the IRA investor;
- has no relationships with IRA investors (other than to provide administrative services after the IRA investor agrees to use its platform);
- does not market itself directly to the retail IRA investor community;
- does not on its own initiative provide suggestions about managing the investments of any IRA, whether or not invested through its platform; and
- does not make “recommendations” within the meaning of the Proposal.

The Platform Carve-out, as it is currently used, necessitates our request for this second platform carve-out. With the same design described above, a platform provider for a plan might rightly conclude it is not an investment advice fiduciary and be content. Nevertheless, the Proposal includes the Platform Carve-out to dispel any uncertainty that these plan platform providers are not fiduciaries. IRA Carve-out Providers deserve the same assurance, either through regulatory recognition that the IRA Carve-out Provider does not provide “recommendations” to the retail IRA community and/or through the requested expansion of the Platform Carve-out to include an IRA Carve-out Provider. Further, the narrow scope of the Platform Carve-out, as drafted, raises the risk that the courts and other regulatory bodies may conclude that the Department intended that all platform providers -- except for those expressly carved out -- should be treated as fiduciaries. If the Department does not intend this result, then the Department must clarify the Program Carve-out by including IRA Carve-out Providers.

### **IRA Carve-out Providers Cannot Give Specifically Directed, Individual Investment Advice.**

A related part of the proposed regulation in the Proposal requires that any recommendation must be “specifically directed to” an IRA or an IRA investor or be “individualized” advice to an IRA or an IRA investor. The IRA Carve-out Provider in this comment does not take either action. It does not know the identities of any prospective IRAs or IRA investors considering offerings on its platform. It does not know the age of the IRA investor or what her investment objectives or risk tolerance may be. It does not personally interact with her. It does not generate any paperwork (e.g., create a brokerage account or document suitability) especially for them (other than IRA custodial documentation if she creates an administrative relationship). The IRA Carve-out Provider does not tailor any of its administrative documentation for any specific IRA investor. The IRA Carve-out Provider cannot know who might ultimately see its product. The IRA Carve-out Provider delivers nothing to retail clients promoting any particular

platform investment over any of the platform's other investments. For these reasons and the reasons explained in the preceding comments, SFG requests regulatory recognition that the IRA Carve-out Provider does not provide "individualized" advice "specifically directed to" IRA investors and/or the expansion of the Platform Carve-out to include an IRA Carve-out Provider requested earlier.

### ***84-24'S IMPARTIAL CONDUCT STANDARDS ARE TOO VAGUE.***

While SFG supports continuing all insurance product coverage under 84-24, it is concerned about the lack of clarity regarding the new "Impartial Conduct Standards" under proposed 84-24. For those IRA providers that would be fiduciaries of an IRA under section 4975(e)(3)(B) of the Code, 84-24 (as proposed) would require them to adhere to standards of conduct predicated on ERISA's fiduciary standards (with a kicker) and not to be misleading about matters relevant to an IRA investor's investment decisions.

IRA providers already seek to not mislead, and they have little familiarity with ERISA's fiduciary standards or how they would change under new 84-24. A lack of clarity regarding appropriate precautions under the new regime will have the effect of driving investment professionals to utilize solutions that are less desirable for the client only in order to seek greater compliance certainty, instead of using an appropriate solution which may not be recommended for fear of the ambiguity of new 84-24.

### **Clarify the Diligence Required by an Investment Professional.**

Clarifying under 84-24 the type and amount of required diligence and a means by which to determine what would be a reasonable number of investment alternatives to evaluate and present would be a helpful beginning for investment professionals in guiding their choices. Because of the vast number of annuity contracts in the marketplace today, it is impractical to expect that an IRA investment professional could be as knowledgeable as an ERISA plan fiduciary should be about the features and benefits of every annuity.

There is also no practical way to effectively evaluate each and every annuity product. Some investments may be more conducive to assessment only because they have explicit objectives, past performance history, stated fees, stated risk parameters and volatility measures. The prospective benefits of certain guarantees are much more difficult to quantify and compare. Additionally, investment professionals have different registrations and licenses that will impact the investment options they are eligible to recommend. The standard should make clear that the Impartial Conduct Standards do not require an investment professional to recommend investment options the professional cannot recommend due to her licensing or registration restrictions or due to limits imposed by her institutional distribution agreements. Providing guidelines or even safe harbors concerning the scope of these aspects of due diligence under new 84-24 will be necessary to achieve the Department's goals.

## **Clarify the New "Reasonable Compensation" Standard.**

Clarifying "reasonable compensation" in light of the Impartial Conduct Standards would help investment professionals gravitate to appropriate solutions, not ones that simply have the fewest chances of running afoul of nonspecific rules. The Proposal's failure to propose a clearer definition of what would be "reasonable compensation" will have the effect of continuing to drive investment professionals to not service IRA investors or to recommend fee-based managed accounts even if a commission-based alternative may be more appropriate and less expensive. Grafting the vague requirements of the Impartial Conduct Standards to this historically slippery determination will accelerate that move. As acknowledged in the Department's Regulatory Impact Analysis, the existing regulatory framework already requires compensation to be fair and reasonable. The report states "[c]ourt decisions and SEC guidance also require a BD's [sic] compensation for services generally to be fair and reasonable based on all the relevant circumstances. Financial Industry Regulatory Authority ("FINRA") rules and guidance also prohibit charging customers unfair compensation. Charging an unfair commission would be viewed as violating principles of trade under FINRA rules."

Investment professionals are aware of what is acceptable based on the current regulatory scheme so simply changing the language to a standard like "reasonable and customary" would provide a greater level of certainty. In addition, greater detail about what the Department considers "reasonable compensation" to be for an IRA fiduciary subject to the Impartial Conduct Standards would give much-needed assistance to those seeking to make recommendations to IRA investors.

## ***MAINTAIN THE LEVEL PLAYING FIELD BETWEEN COMMISSION-BASED TRANSACTIONS (THAT ARE IN THE BEST INTERESTS OF THE CLIENT) AND FEE-BASED ARRANGEMENTS.***

### **Access to Human Investment Professionals Matters.**

It is widely accepted that investors who work with an investment professional save more and are more confident in their ability to have a secure retirement. Over time, the differences between those who work with an investment professional and those who do not grows. Analysis shows that for essentially identical investors (income, age, etc.), investors who work with an investment professional instead of going it alone<sup>1</sup>:

- Have 58% more assets after 4-6 years;
- Have 99% more assets after 7-14 years; and
- Have 173% more assets after 15 years.



Investment professionals address many needs of clients, including investments, budgeting, savings guidance, asset management, retirement risks, and managing or paying down debt. A 2014 client survey indicated that pre-retirees who work with an investment professional are more likely to complete key planning activities.<sup>2</sup> Those clients who work with an investment professional are more likely to:

- Calculate the amount of assets available for retirement;
- Determine income in retirement;
- Determine what expenses will be in retirement;
- Estimate how many years assets will last in retirement; and
- Identify activities planned and their likely costs.

Today, there are avenues of financial guidance other than investment professionals (including online advice), but these tools have not been proven to increase client confidence in a secure retirement and generally fail to meet the needs of many clients. A 2012 study<sup>3</sup> found that 60% of 18-34 year olds used online financial tools, but only 19% of clients 65 and older said they used such tools. A 2015 study found that investors of all generations preferred human advisors over computer algorithms. Millennials and Gen-Xers preferred the human advisor 60% of the time, Boomers favored the human advisor 70% of the time, and Mature Investors preferred the human advisor 76% of the time.<sup>4</sup> So-called “robo-advisers” currently serve only a miniscule number of clients today. Investment professionals, currently and in the future, will play a key role in helping clients prepare for a secure retirement.

### **The Right to Compensate with Commissions Affects Access.**

It is generally acknowledged and understood that in certain instances, fee-based managed accounts are the appropriate solution for certain clients, while commission-based products are the appropriate choice for others. The Department would not have allowed commission-based products to be presented at all by a fiduciary if this were not the case. The Securities and Exchange Commission (“**SEC**”) also recognized this when it revealed that it was looking into cases of “reverse churning” where managed accounts were recommended to clients who were better served in their existing commission-based account. It was acknowledged that in instances where the client had less need for ongoing monitoring and/or they were focused on a “buy and hold” strategy that managed accounts resulted in unnecessary fees to the client. A study showed that the average fee charged for managed accounts under \$250,000 was 1.26%.<sup>5</sup> The Consumer Federation of America agreed that commission-based accounts are sometimes appropriate when it stated “all forms of compensation involve conflicts [but] investors sometimes have sound reasons for preferring to pay for advice through sales fees.”<sup>6</sup>

A significant concern arising from the Proposal's approach to commission-based compensation is the effect it would have on small, middle income investors' access to an investment professional, specifically regarding their IRA investments. While the Proposal allows commission-based transactions, the Proposal's conditions make it largely impractical for investment professionals to serve small, middle income investors with commission-based products. Fee-based managed accounts generally have such high minimums that they are not affordable or practical for small to medium sized accounts. A study by management consulting firm Oliver Wyman<sup>7</sup> based on the Department's original proposal examined the effect that eliminating commission-based transactions would have on IRA clients. The study concluded that if commission-based transactions were eliminated, small and medium investors interested in receiving advice regarding their IRA would have less access to investment professionals for guidance and support, making it less likely that they would even open an IRA. Those that do work with a fee-based investment professional would likely pay significantly higher cumulative fees on their IRA than they would pay for investments managed outside of fee-based accounts. In addition to the higher cumulative fees, the transaction charges assessed by many fee-based managers would be more significant to small, middle income investors. Large account owners and high income individuals who value the features and benefits of the fee-based managed account would continue to receive investment advice and thus may not be adversely impacted. But even large account owners who value working with an investment professional but do not want to pay the ongoing fees and charges associated with a fee-based managed account may find themselves on their own regarding their IRA rollover. Keeping access to investment professionals affordable for small, middle income investors should be an important consideration of any regulatory framework. While the Proposal assumes that commission-based transactions are allowed and virtually unaffected, the current Proposal does significant damage to established business models that currently serve millions of IRA investors.

Other findings from the Oliver Wyman study were that 18 million small IRA investors would lose access to their investment professional if commission-based transactions were eliminated, that nearly one million fewer new IRAs would be opened each year, that small businesses could stop setting up new 401(k)s and that the overall impact would be the loss of \$240 billion in retirement savings over the next 20 years. Clearly this is not a desirable outcome as the current levels of retirement savings are already a major problem facing this country and its citizens. Nearly 40% of IRAs in the Oliver Wyman study sample had less than \$10,000, and 98% of investor accounts with less than \$25,000 were in brokerage relationships. The Proposal could curtail access to meaningful investment services for over 7 million IRAs. Maintaining access to a wide range of investment options for IRA investors by small, middle income investors should be a critical element of any revisions to the Proposal.

## **The Right to Compensate with Commissions Affects Investment Choices.**

The Best Interest Contract Exemption (“**BICE**”) is a well-intentioned exemption that would allow fiduciaries to continue to receive compensation that would otherwise be prohibited under the Proposal. Unfortunately, the BICE would create an unlevel playing field which would likely result in more fee-based managed accounts even if a commission-based product would more appropriately meet the needs and goals of the client. This is due to its onerous conditions placed on commission-based sales that do not apply to fee-based managed accounts. It seems illogical that when fee-based managed accounts and commission-based transactions are held to the same legal standard under ERISA, the conditions for commission-based products would be so much more onerous. The Proposal seeks to harmonize the standard but creates a significantly greater burden on commission-based products (even after the investment professional warrants that they are acting in the best interest of the client).

A major concern with the Proposal is that if commission-based sales were significantly curtailed, that would also limit choices available to investors. Fee-based managed accounts generally offer a certain menu for investors, but numerous other financial alternatives may not be available in a fee-based account. Due to the substantial cost and complexity of implementing the requirements of the BICE, eliminating commission-based products in IRAs would be an easier way for investment professionals to implement the Proposal, but with the corollary of limiting investors to fee-only managed accounts. Ironically, the commission-based investments could be more appropriate for the IRA investor and may result in lower cumulative fees over time. For instance, a front-end loaded mutual fund would likely result in lower long term costs relative to a mutual fund in a fee-based account. Also, many investments that offer significant guarantees (e.g., lifetime income, death benefits) such as annuities are either not as appealing in a fee-based account or simply cannot be offered in a format that fits a fee-based platform.

## **The Right to Compensate with Commissions Affects Leakage.**

It would appear that one of the more significant objectives of the BICE is to ensure that plan participants understand their options and make informed decisions. One of the tragedies today is that uninformed workers who cash out of a retirement plan have to face taxes and penalties on the distribution because they do not put that money toward the original purpose of retirement. This has a devastating impact on retirement readiness for millions of Americans. According to a 2012 study<sup>8</sup> of all workers who terminated their employment in 2011, 40% took cash distributions instead of remaining in their current plan, rolling their balance over to a new defined contribution plan or rolling over to an IRA. Another 2012 study<sup>9</sup> showed that for tax year 2010, there were \$123.9B of taxable distributions from retirement accounts to taxpayers under age 55. Of these taxable distributions, \$46B was subjected to a penalty tax. These cash outs are a

major issue for Americans, and their impact clearly should have been included in the Department's cost-benefit analysis.

Employees are less likely to take cash distributions of their retirement savings if they can discuss their options with a call center or investment professional upon employment termination. One company found that terminating employees with account balances between \$35,000 and \$50,000 were approximately 3.2 times less likely to cash out their retirement savings if they were to receive a call from an investment professional representative of the company compared to similarly situated employees who received only written communications.<sup>10</sup> The same study also suggested that cash outs could increase from \$20-\$32 billion annually if investment professional access were curtailed. While it is difficult to judge whether that number is correct, it is indisputable that cash outs would likely increase.

It is crucial that this Proposal not harm access to investment professional guidance. One of the best ways to modify the Proposal to ensure adequate access to an investment professional is to return to a level playing field between fee-based and commission-based solutions, particularly regarding the BICE conditions.

### **BICE Disclosure Requirements Ignore the Existing Regulatory Framework and Create Inequitable Barriers to Commission-Based Solutions.**

The disclosure requirements under the BICE are especially troublesome. The disclosure conditions are complex and overlap with existing disclosures required in the current regulatory framework. BICE adds an enormous amount of disclosure and by so doing, creates unprecedented and commercially unworkable requirements that effectively render the BICE impractical to use. The conditions would require a massive amount of information that is effectively of little use to the client in assessing the investment professional's financial interests. The material that must be made available to the Department could be requested in a manner other than as a condition to receiving the protections afforded under the BICE. Far more data and disclosure are required under the Proposal with respect to a small IRA than are required to be provided to a retirement plan with thousands of participants.

1. *The BICE disclosure conditions are onerous.* These disclosures are complex and overlap with existing disclosures required in the current regulatory framework. These requirements place further burdens on investment professionals who seek to do what is in the best interest of the client if that calls for a commission-based solution. This further incentivizes investment professionals to not serve small and middle income investors. These conditions will cause many investment professionals to conclude that commission-based sales are not practical at all, even if they are in the best interests of the client.

There currently exists significant disclosure requirements to IRA investors at the initial transaction and thereafter. At the initial transaction, disclosing fees and

compensation is already part of the existing regulatory framework. Ongoing statements show assets, purchases and sales and the applicable price. In addition, fees are disclosed on an annual basis. By adding additional disclosure, little value is added, but complexity and cost for all parties to the client's engagement with the investment professional is increased substantially.

SFG is not aware of any current systems in the financial services industry that can deliver the disclosures (as proposed) today. Massive systems changes would have to be implemented in order for these disclosures to be produced. Once again, this is a significant disincentive to offering commission-based solutions even if they are more appropriate for the investor than a fee-based account. These disclosure requirements will take an estimated tens of millions of dollars to build, as all aspects of the financial services supply chain will have to provide information in a yet to be determined standardized format in order for these conditions to be executed. The significance of these conditions will put undue burden on smaller firms that do not have the financial resources to execute the conditions. The costs shown in the Proposal were wildly low and demonstrate that the magnitude of these requirements is clearly not understood by the Department. Also, it would be impractical for these conditions to be implemented in less than 3 years and possibly even longer.

The most practical solution is to establish a uniform best interest standard and harmonize with the current requirements of the SEC and FINRA regarding disclosure of fees of investing and investment professional compensation and eliminate the additional and onerous BICE disclosure conditions.

2. *The BICE webpage requirement is impractical.* The additional webpage conditions of the BICE add little value to the IRA client, but put a hefty cost and administrative burden on investment professionals to comply. This would be a massive build and will undoubtedly put an undue burden on smaller investment professionals who already struggle to stay afloat while assisting their clients due to current regulatory and compliance costs.

In addition, the requirement to show compensation on any product that could possibly be purchased is highly impractical if not impossible. Ironically, this condition incents a financial firm to reduce the number of investments it allows its investment professionals to offer. This further reduces investment choice for the client. The goal of the Proposal should be to provide better outcomes for the client. This condition does not advance that goal.

Due to the coordination of systems required to execute this condition as proposed, the expected costs shown in the Proposal are wildly low. This condition alone could possibly take at least 3 years to implement due to the number of systems that would have to sync up to provide the mandated information.

Again, the most practical solution would be to rely upon the existing regulatory disclosures which currently require compensation disclosure. By harmonizing the BICE's webpage disclosures to the existing regulatory scheme, the Proposal could be implemented with far less client confusion, less cost, far less time and with far less disruption to the current business models which serve clients today.

### **BICE Contracts Should Allow Negative Consent or Signing at the Time of a Transaction.**

The BICE will make contracts mandated and commonplace. By requiring the BICE contract in order to purchase a commission-based investment, the Proposal has placed an enormous burden on the client. Contract interpretation requires a great deal of skill and understanding. The vast majority of prospective clients are most likely not equipped to comprehend the terms and conditions that may be included in the BICE mandated contract. The goal of enhancing client protections is not being served by enabling fraudulent bad actors through an environment where potentially dangerous contract terms (such as powers of attorney) can be included in contracts "required by law," unbeknownst to clients, in order to simply receive investment services. The bad actors that will benefit from prospective clients that have been desensitized to the serious nature of legal contracting will most likely not be concerned with the consequences associated with violations of regulatory rules.

As proposed, the BICE currently would require a contract to be entered into prior to engaging the client in a discussion regarding their retirement investment options. This contract timing is simply unworkable. At that time of the relationship, the investment professional will not be certain he/she will need to rely on the BICE or another exemption. Entering into the contract prior to even starting a discussion could also have the effect of alienating retirement clients. In many instances, the investment professional will not yet have a relationship with a client, because the client is determining if they want to begin working with the investment professional. Yet, before even having a relationship, the investment professional would have to put a BICE contract in front of the client that could intimidate and/or drive away the client. This is clearly not the outcome the Proposal seeks to achieve. These requirements place further burdens on investment firms and investment professionals who seek to do what is in the best interest of the client if that calls for a commission-based solution. This further incents investment professionals to not serve small, middle income investors. This BICE requirement will cause many investment professionals to conclude that commission-based sales are not practical, even if the investment is appropriate and the investment professional is acting in the best interest of the client.

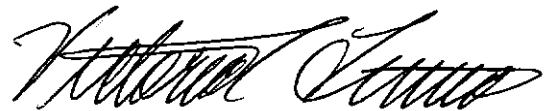
Assuming the BICE can be modified to serve all of the clients' interests, the simple and practical implementation would be to either require the BICE contract to be signed at the time of an investment (when the investment professional would be eligible to receive compensation), allow for negative consent to the BICE contract or simply

permit the investment professional to make unilateral representations and warranties. The investment professional would be certain to deliver the binding document; otherwise, they would not be able to rely on the BICE.

\* \* \*

We thank the Department for the opportunity to comment on the Proposal. Please address any questions to the undersigned.

Sincerely yours,



## Sources/Exhibits

1. Centre for Interuniversity Research and Analysis on Organizations, "Econometric Models on the Value of Advice of a Financial Advisor."
2. LIMRA Secure Retirement Institute 2014 Consumer Survey.
3. Study sponsored by TIAA-CREF and cited in a MarketWatch article -"Retirement Planning Advice for the Wise" (11-12-2012).
4. Charles Schwab's "Man and Machines" report (May 2015).
5. Report at /www.wealthmanagement.com (June 2015) "Compensation Survey 2015."
6. Consumer Federation of America, "DOL Delivers on its Promise: Conflict of Interest Rule Proposal Provides Needed Protections for Retirement Savers, Flexibility for Financial Firms" (2015).
7. 2011 study by management consulting firm, Oliver Wyman - "Assessment of the impact of the Department of Labor's proposed "fiduciary" definition rule on IRA consumers."
8. AON-Hewitt study cited in an article on CNBC.com – "Stop Juggling That Handful of 401(k)s and IRAs" (9-19-12).
9. Argento, Bryant and Sabelhaus, cited in April 9,2014 study by Quantria Strategies, LLC, "Access to Call Centers and Broker Dealers and Their Effects on Retirement Savings."
10. April 9, 2014 study by Quantria Strategies, LLC, "Access to Call Centers and Broker Dealers and Their Effects on Retirement Savings."



## Man and Machines: New Charles Schwab Study Examines How Different Generations Approach the Use of Technology

Study finds no link between age and affinity for technology;  
 People still need people, across the generations

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**SAN FRANCISCO—(BUSINESS WIRE)—**Nine out of 10 Americans view technology as more of a life necessity than a distraction but a passion for people persists across the generations, according to a new study from Charles Schwab which finds that people from age 25-75 prefer to rely on a combination of both humans and technology when it comes to dealing with daily tasks and managing their money.

"We need to find a way to get this generation started on the path to investing, and that will require more than a pure technology-based approach."

The Charles Schwab "Man and Machines" study asked more than 1,800 affluent consumers across four generations about their interaction preferences for finding answers and solving problems across a range of topics, and although technology won out over people, the result was close – just over half (54%) say they prefer to rely on technology while 46 percent still favor interactions with people they know or to whom they are referred. In examining viewpoints by generation, the study revealed some surprising differences and similarities, particularly when comparing Millennials and Gen-Xers, which suggest that age is not a defining factor in how people approach the use of technology.

### A Generational Divide?

When asked to choose between relying on a financial advisor and a computer algorithm for managing their portfolios, two-thirds (66%) of all respondents say they still prefer the human touch, and Gen-Xers are just as likely as Millennials to prefer a portfolio based on a computer algorithm (40% versus only 30% of Boomers and 24% of Matures).

The study also found that Gen-Xers are in fact more plugged in than the Millennial generation when it comes to investing: they are more likely to rely on technology when trading stock and when creating or maintaining a financial plan. Millennials appear to be seeking alternatives to technology: they are more likely than any other generation to feel relief from leaving their devices at home when vacationing, and more likely to turn toward familiar sources like their parents instead of seeking answers online on financial matters.

"We've come to accept as fact that Millennials are hyper-focused on using technology and the internet for all their needs, but it's clearly more complicated than that," said Naureen Hassan, Charles Schwab executive vice president and head of Schwab Intelligent Portfolios™, the new automated investment advisory service from Charles Schwab.

Hassan noted that, like other studies, Charles Schwab's new research indicates that Millennials are far less likely to invest (62%) than Matures (67%), Boomers (79%) and Gen-Xers (72%), and far more likely to put their money in a savings account (38%) than Matures (13%), Boomers (21%) and Gen X (28%). "Retirement may seem far away, but starting early can have a significant impact down the road," she emphasized. "We need to find a way to get this generation started on the path to investing, and that will require more than a pure technology-based approach."

### Common Ground between Millennials and Gen-X

The study also found that Millennials and Gen-Xers are more similar than commonly accepted and larger divisions are found between the two younger generations and their older counterparts, particularly when it comes to personal service:

- Millennials and Gen-Xers are less willing to pay more for personal service (44% and 47%) than Boomers and Matures (55% and 56%)
- Millennials and Gen-Xers are less likely to want to discuss investing strategies with a professional (49% and 48%) compared to Boomers and Matures (61% and 67%)
- Millennials and Gen-Xers are more likely to prefer to automate investing decisions (51% and 52%) compared to Boomers and Matures (39% and 33%)

### Reliance on Technology Has Limits for Everyone

Revealing a general acceptance and trust in technology when it comes to money, Charles Schwab's study found that investors across all generations and asset levels trust that their money is safe when they manage accounts online (66%). However, there are clear signs that trust in online interactions can vary depending on the nature of the interaction. Although technology is the preferred mode for transactions like booking a flight (96%), getting directions (95%), researching a new car (91%), and planning a vacation (90%), respondents feel differently when it

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comes to more private matters. Across the generations, the vast majority say they prefer to interact in person when dealing with a health issue (80%) or finding a date (68%).

When it comes to investing, the human touch still appears to be crucial in certain situations, especially for Millennials and the ultra-high net worth. Findings that illustrate a preference for personal interaction when it comes to investing include:

- Seventy-five percent of Millennials are more interested in talking with a professional advisor when their financial situation gets more complicated compared to 72 percent of Gen-Xers, 71 percent of Boomers and 64 percent of Matures
- Sixty-four percent of Millennials are more interested in talking with a professional advisor when they have a significant life event like getting married, having a child or dealing with a death in the family compared to 60 percent of Gen-Xers, 60 percent of Boomers, and 53 percent of Matures
- The ultra-high net worth (\$1 million+) are least likely to prefer automated investing (39%) or a portfolio based on a computer algorithm (28%)

"What we've found in this study and in our interactions with investors over the years is that there isn't a 'one size fits all' answer for how people want to invest or manage their money – they will likely always want a range of services that incorporate both technology and a human touch," said Hassan, who also oversees client experience at Schwab and the firm's wealth management capabilities. "That's why at Charles Schwab we'll continue to focus on offering a variety of wealth management services to give people choice and flexibility – whether that's online automated investing, support from financial consultants in our branches, managed portfolio solutions that address a variety of investment goals and circumstances, or tools and resources to help people who want to go it alone."

#### About the survey

The survey was conducted by Charles Schwab, one of the largest full-service investment services firms in the country with \$2.53 trillion in total client assets, and Koski Research. The online survey was fielded between February 18 and 26 among 1,808 consumers. The margin of error for the total survey sample is 2.3 percentage points.

#### About Charles Schwab

At Charles Schwab, we believe in the power of investing to help individuals create a better tomorrow. We have a history of challenging the status quo in our industry, innovating in ways that benefit investors and the advisors and employers who serve them, and championing our clients' goals with passion and integrity. More information is available at [www.aboutschwab.com](http://www.aboutschwab.com). Follow us on Twitter, Facebook, YouTube and LinkedIn.

#### Disclosures

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# COMPENSATION SURVEY 2015

## Compensation Survey 2015: The Slowly Disappearing Commission

Megan Leonhardt | 2015 Compensation Survey

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**How This Survey Was Conducted:** Between April 16-30, 2015, WealthManagement.com emailed invitations to participate in an online survey to print and web subscribers and advisors in the Meridian-IQ database across all advisor channels. By April 30, a total of 944 responses were received (Wirehouse/national firm/super-regionals: 250; Regional brokerage firms: 58; Independent b/d: 187; RIA not affiliated with a b/d: 121; RIA affiliated with a b/d: 112; Bank brokerage: 97; Bank trust or private client department: 50; All other: 29). Advisors were asked over 30 questions on their current compensation payout, structure and satisfaction level, as well as how those factors have changed over the past year.

### What is in this article?:

Compensation Survey 2015: The Slowly Disappearing Commission

The Shift to Fees

Total Compensation 2014

Being a Fiduciary Pays Off

'Outlook Looks Pretty Good'



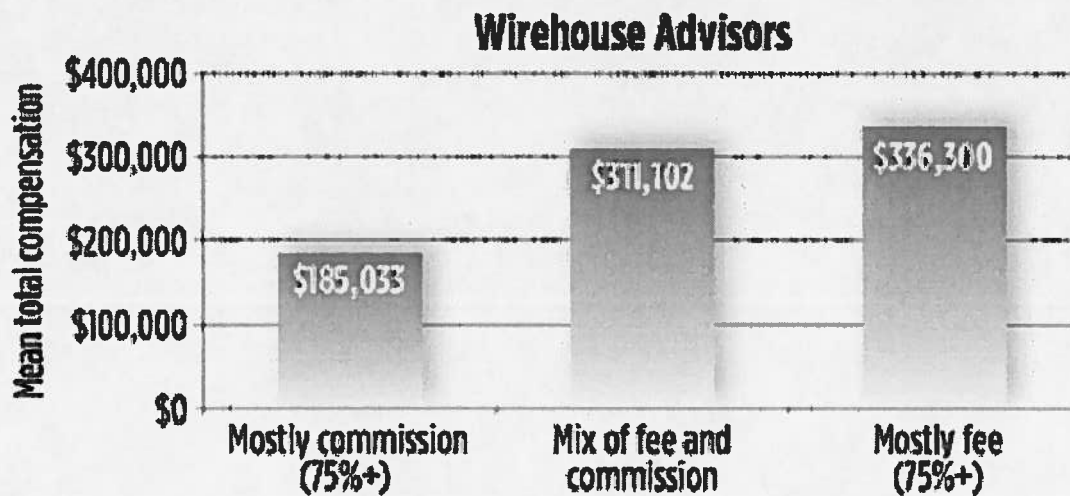
Moving from a commission-based business to one based on fees, advocates argue, removes conflicts and puts advisors on the same side of the table as their clients.

It also pays better. A lot. According to WealthManagement.com's annual compensation survey, even at the wirehouses, advisors whose business mix leans more toward fees make almost twice those who still lean heavily toward commissions.

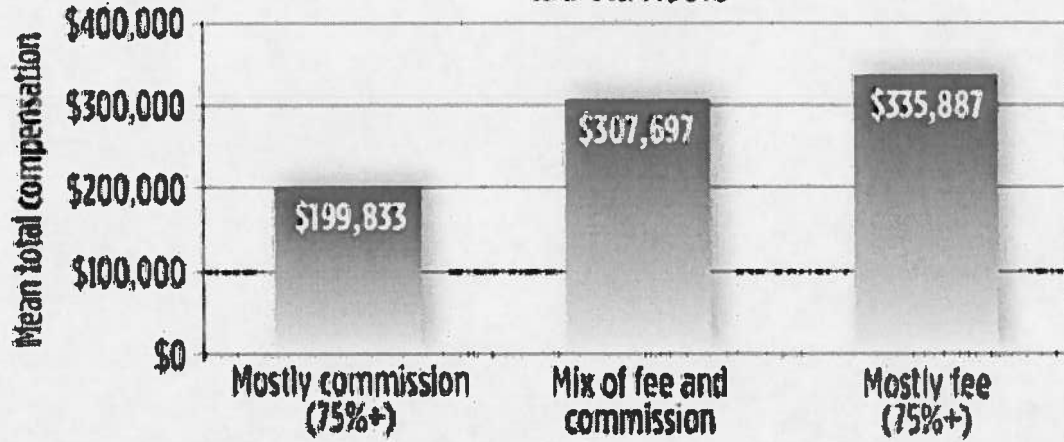
"You're not even trading off compensation for stability," says Gary Shub, a partner in the financial services practice of The Boston Consulting Group. "A fee-based business offers a steady stream of recurring revenue, and the compensation level ends up being higher. We still talk about fee-based as a trend, but the reality is it's certainly more than 50 percent of the revenue of the business."

## MORE FEES PLEASE

A fee-based business pays better, even for brokers.



## IBD Advisors



The Shift to Fees »

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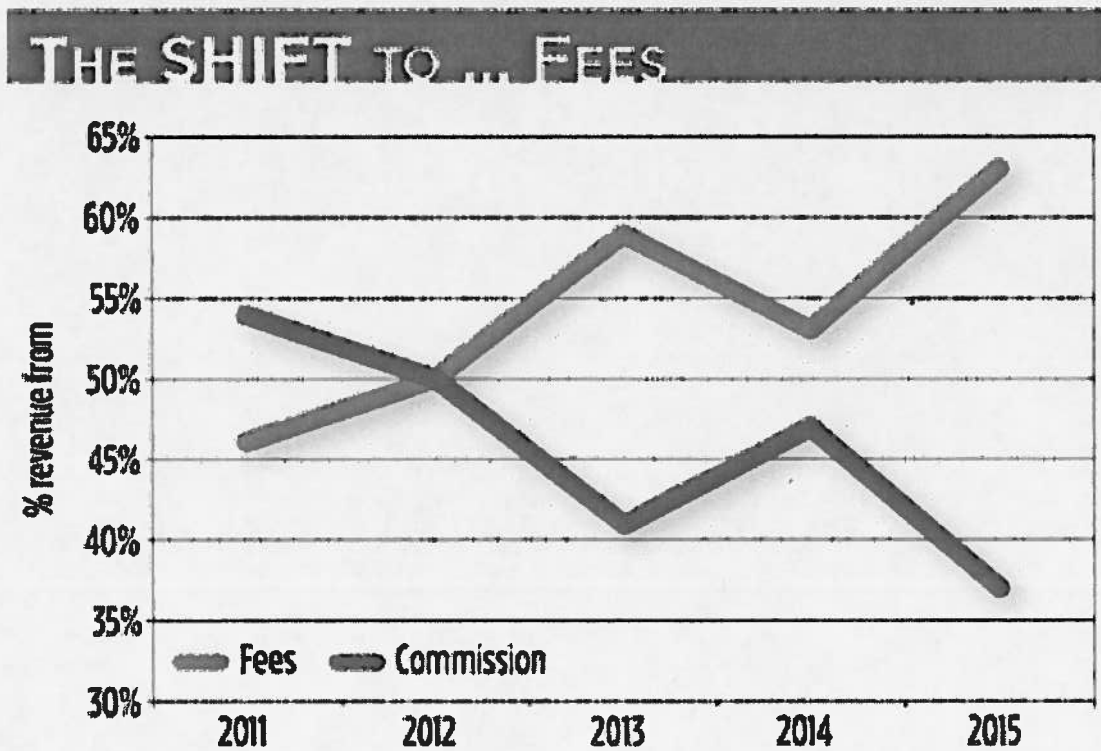
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## The Shift to Fees

Five years ago, fees accounted for less than half of all advisors' revenue. But last year, advisors derived about

63 percent of their revenue from fee-based business and about 37 percent from commissions, according to the 2015 survey in which almost 950 advisors from all channels participated in April.

Among wirehouse and independent broker/dealers, advisors reported generating, on average, about 60 percent of their revenue from fee-based businesses.



And why not? Wirehouse advisors who have more than 75 percent of their business in fees earned an average of \$336,300. Those who based more than 75 percent of their business on commissions earned an average of \$185,000. The same held true for advisors at IBDs. Those with a majority fee-based business earned an average of \$335,900, compared to those with a predominately commission-based business generating just \$199,800.

Overall, financial advisors saw their compensation grow by 12 percent to an average of \$262,600 last year, according to the survey. Total compensation was up from the previous year for more than seven out of 10 advisors; almost a third said it was up by more than 20 percent.

Hybrid advisors working at an independent registered investment advisory firm affiliated with a broker/dealer took home the biggest paychecks in 2014—about \$314,300 on average, according to the survey results. Wirehouse advisors came in second with an average \$295,800 in total compensation reported, followed by advisors at IBDs with \$283,900.

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## Total Compensation 2014

"Over the last several years, we've seen very little growth in the number of advisors. But if you look beneath the surface, the overall quality of the advisors has risen," says Dan Inveen, principal and director of research at FA Insight. "(Fee-based business) is a more complex type of business and it's not an easy transition."

But for those who are capable of it, the benefits are tangible.

### TOTAL COMPENSATION—2014

Including fees, commissions, deferred compensation, and bonuses.

All respondents	Estimated Mean	Estimated Median	Number of Respondents
	\$262,583	\$206,250	944
<b>Firm Type</b>			
Wirehouse/national firm/super-regional	\$295,808	\$256,250	250
Regional brokerage firm	\$277,345	\$177,428	58
Independent broker/dealer	\$283,850	\$245,237	187
Independent RIA, not affiliated with a b/d	\$234,967	\$179,766	121
Independent RIA, affiliated with a b/d	\$314,313	\$266,666	112
Bank brokerage	\$200,969	\$155,555	97
Bank trust services or private client department	\$197,325	\$166,666	40
Insurance broker/dealer	\$195,480	\$144,444	50
All other	\$216,724	\$183,333	29

Business	All respondents	Wirehouse/national firm/super-regional	Regional brokerage firm	Independent broker/dealer	Independent RIA, not affiliated with a b/d	Independent RIA, affiliated with a b/d	Bank brokerage	Bank trust services or private client department	Insurance broker/dealer	Other
Average Assets Under Management (in millions)	\$153.6	\$173.2	\$128.2	\$88.1	\$218.0	\$155.9	\$117.8	\$204.2	\$34.5	\$248.7
Gross Production	\$875,802	\$1,003,740	\$749,537	\$605,200	\$1,082,417	\$937,634	\$650,833	\$1,401,667	\$493,100	\$1,491,667
Average Payout	51%	40%	43%	74%	50%	70%	33%	23%	48%	39%

Overall, advisors saw a 15 percent bump in assets under management, outperforming the S&P 500's 12 percent rise last year. The average advisor had about \$154 million in client assets under management. While hybrid RIAs experienced the highest level of growth with a 19 percent increase in client assets, all advisor channels increased their level of assets under management within a few percentage points of one another.

"Who is actually successfully working to increase assets and not just riding the wave? This is a troubling trend," says Matt Lynch, founder of the Ohio-based consulting firm Strategy & Resources.

While market impact was likely the dominant driver of the 15 percent AUM growth, BCG's Shrub says fee-based advisors seem to be better at consolidating assets.

"They're not just winning new clients into the fee-based model, but then over time (they) are able to attract the clients' assets that may have been held elsewhere," he says.

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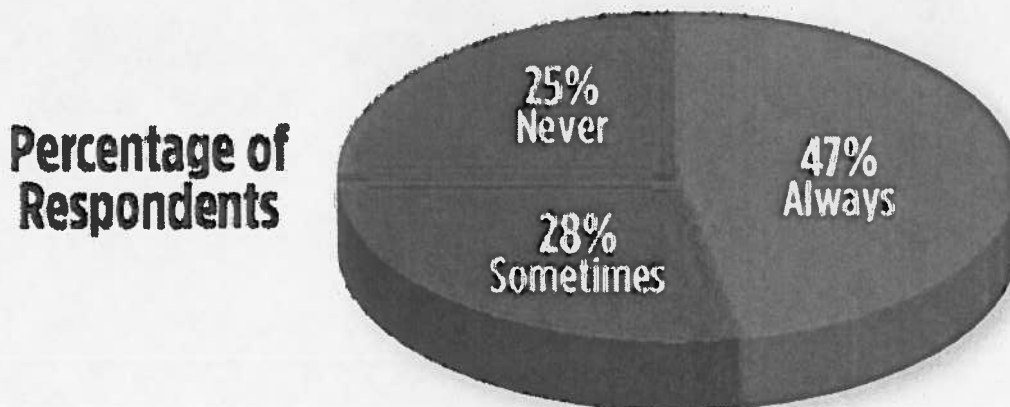
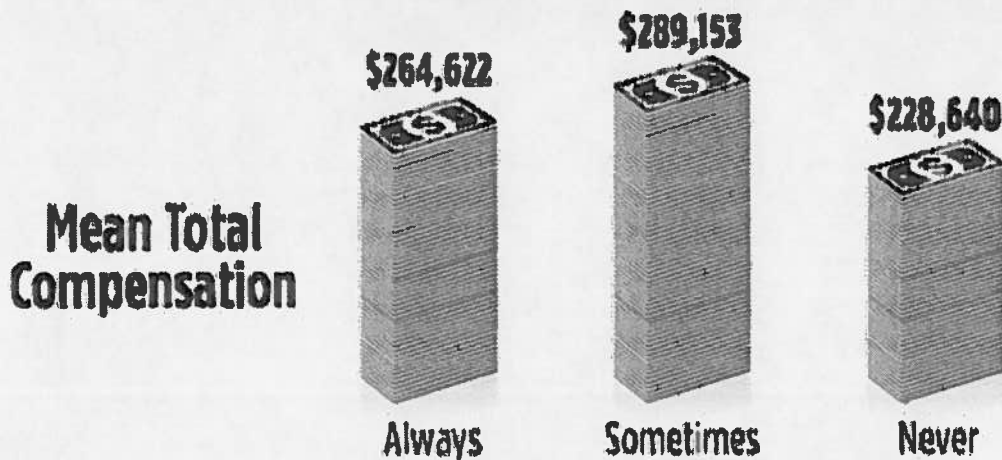
## Being a Fiduciary Pays Off

According to the survey, advisors across all channels increased the number of clients they serve by 8 percent; pure RIAs (those not affiliated with a b/d) grew the client base 10 percent, and hybrid advisors by 9 percent.

Excluding market performance, 78 percent of advisors said clients invested more money than they took out over the past year. Only 7 percent of advisors overall saw more money leave their firm than come in.

## ACTING IN CLIENTS' BEST INTEREST PAYS OFF

Do you act as a fiduciary with regards to clients?



## 'Outlook Looks Pretty Good'

Advisors are optimistic the trend will continue, anticipating they will grow their total take-home pay by another 12 percent in the upcoming year. "If you're an employee-based advisor, the outlook looks pretty good because all the signs point toward continued healthy growth in the rate of compensation," Inveen says.

But Lynch questions how optimistic advisors should really be. "Everyone thinks their compensation will grow about the same year over year, but I wonder what percentage of that growth is tied to new business, compared to those who are expecting to just ride the wave of market action," Lynch notes.

Firm owners may also have cause for concern. "If you're a firm owner, however, you should probably be a little concerned about how you're going to source labor and manage higher costs related to compensation of your staff," Inveen cautions. While the market demand for advice continues to grow, the supply of advisors has not.


About 37 percent of advisors participating in the 2015 survey reported being an owner or principal of a firm. Half of the pure RIA respondents and 66 percent of hybrid RIAs reported being an owner or principal.

### Next: Can the Hourly FA Survive?

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## **DOL Delivers on its Promise: Conflict of Interest Rule Proposal Provides Needed Protections for Retirement Savers, Flexibility for Financial Firms**

In mid-April, the Department of Labor did what many thought to be impossible: it issued a proposed rule that strengthens protections for retirement savers by requiring all financial professionals to put the interests of their customers first, but does so in a way that enables financial professionals who are compensated through sales commissions to comply. By simultaneously closing loopholes in the definition of investment advice under the Employee Retirement Income Security Act (ERISA) and permitting the receipt of sales-based compensation subject to certain conditions, the revised rule proposal effectively addresses the concerns raised by industry regarding the original 2010 proposal while enhancing its investor protection benefits. With the revised rule now out for public comment, this document is designed to answer some of the key questions that have been raised.

### **How are retirement savers being harmed under the current regulatory approach?**

American workers and retirees are more dependent than ever on financial professionals to help them navigate the complex decisions they must make to fund a secure and independent retirement. Unfortunately, because of loopholes in rules specifying who is a “fiduciary” under ERISA, many of the financial professionals that retirement savers rely on for advice are free to put their own financial interests ahead of the interests of their customers. While many of these professionals nonetheless seek to do what is best for their customers, others take advantage of gaps in the regulations to steer their clients into high-cost, substandard investments that pay the adviser well but eat away at retirement savers’ nest eggs over time. This is a particular problem for small savers – including many women and people of color – who are disproportionately likely to be served by non-fiduciary advisers and to receive conflicted advice. Stemming the tide of financial losses attributable to conflicted advice, as this rule seeks to do, is a concrete step that we can and should take to address our nation’s retirement savings crisis.

### **What is the extent of the harm to retirement savers?**

The cost to retirement savers of conflicted advice is enormous. Working from a wide range of independent studies, DOL estimates that investors will lose somewhere between \$210 billion and \$430 billion over 10 years, and between \$500 billion and \$1 trillion over 20 years, as a result of conflicted advice just with regard to mutual fund investments in Individual Retirement Accounts (IRAs). Furthermore, a retirement saver who moves money out of a 401(k) plan and into an IRA based on conflicted advice can expect to lose 12 to 24 percent of the value of his or her savings over 30 years, according to the DOL analysis. Overwhelming evidence from a wide variety of sources supports the conclusion that these losses are the direct result of financial advisers’ freedom to place their own financial interests ahead of the interests of their customers when offering retirement investment advice.

DOL details the basis for these estimates, and broader conclusions about the harmful impact of conflicts of interest, in a comprehensive Regulatory Impact Analysis (RIA) issued at the same time

as the revised rule proposal. As DOL explains in the RIA, it chose to focus on mutual fund investments in IRAs to quantify the harm, not because this is an area considered to be particularly prone to abuse, but rather because it is where the best data is available. If data were available to support an estimate of the cost to retirement savers of all aspects of conflicted advice, the total would likely be significantly higher.

### **How does the rule fix that problem?**

The revised rule proposal closes loopholes in the definition of investment advice, so that anyone who provides individualized investment recommendations to retirement savers would be covered by ERISA's fiduciary duty. As fiduciaries, they could no longer legally put their own financial interests ahead of the interests of their customers. The rule proposal covers advice to traditional and defined contribution pension plans, such as 401(k) plans, as well as advice to plan participants and to those who save through Individual Retirement Accounts. In an important improvement over the 2010 proposal, it covers advice about recommendations to roll money out of a pension or 401(k) plan and into an IRA. This is the most important financial decision many people will ever make, with a potential to seriously affect their standard of living in retirement, and it is an area of well documented abuses.

### **I've heard the rule would make it impossible for broker-dealers, insurance agents and others who charge sales fees to offer retirement investment advice. Is that true?**

No. One of the most significant enhancements in the revised rule proposal is the addition of an exemption that spells out the terms under which financial firms and their advisers can receive sales-based compensation and still comply with the ERISA fiduciary standard. Known as the "best interest contract exemption," this provision ensures that broker-dealers, insurance agents, and others who are compensated through commissions and other forms of sales fees will continue to be able to offer retirement investment advice to both small savers and small plans. As such, it preserves the ability of retirement savers to choose how they prefer to pay for retirement advice without requiring them to give up their right to best interest recommendations when they choose to pay through sales fees.

### **Won't permitting advisers to earn sales fees put retirement savers at risk?**

Some have suggested that the only acceptable approach is to continue to ban all sales-related compensation. This view ignores the reality that all forms of compensation involve conflicts and that investors sometimes have sound reasons for preferring to pay for advice through sales fees. It also ignores the strong protections for investors included in the "best interest contract exemption." First, the exemption for sales-based compensation only applies to advice regarding a range of investments that are appropriate for retirement accounts. Both the firm and the adviser providing the retirement advice would be required to enter into a contract with the advice recipient stipulating that they will provide advice under a fiduciary standard and make recommendations that an impartial expert would view as serving the best interests of the retirement saver. The fees charged for that advice would have to be reasonable. Advisers would also be required to provide retirement savers with point-of-sale and on-going disclosures regarding the costs and conflicts associated with the advice.

In perhaps its most significant provision, firms that rely on the exemption would be required to take meaningful steps to eliminate practices that could encourage their advisers to make recommendations that do not serve the best interests of the customer. For example, while firms would remain free to recommend in-house products, they could no longer set quotas for the sale of such products and base advisers' bonuses on their success in meeting those quotas. Similarly, while

firms would be free to pay their advisers more to sell certain investments, those differential payments would have to be based on objective factors, such as the amount of time necessary to research and implement the investment strategy, and not just on a desire to promote sales of particular investments. This has the potential to dramatically reduce harmful business practices associated with sales-based compensation.

Together, these rule provisions should limit the potentially harmful impact of compensation-related conflicts of interest while providing the benefits of investor choice.

**I've heard that small savers could lose access to valued services if rule is adopted. Is this true?**

The argument that small savers would lose access to advice was based primarily on the assumption that the rule would prevent advisers from earning sales commissions. That concern, always exaggerated, has been fully addressed through the proposal of the best interest contract exemption for sales-based advisers. Some have made a similar argument with regard to compliance costs and litigation risks posed by fiduciary status. But investment advisers who currently serve small savers have shown that it is possible to serve this market profitably under a fiduciary standard.

The only remaining question is whether certain firms will decide that it is simply not financially beneficial for them to serve small savers if they are no longer allowed to profit unfairly at their expense. We believe most firms will choose to continue to serve this market. However, should some abandon the field, other market participants are ready, willing, and able to step in and offer high-quality, low cost advice to these individuals. As the RIA explains, this is an evolving market. In addition to the traditional advisers who already serve this market under a fiduciary standard, so-called "robo-advisers" – service providers that utilize technology to meet the core portfolio management needs of mass retail investors – and products such as target date funds "minimize the need for complex advice [and] are already rapidly gaining market share. Going forward, they promise to make advice far more affordable for small investors, especially young investors who generally are more accustomed to technology-based tools. More traditional advisory firms are scrambling to develop, partner with, or acquire such innovative tools, and to combine these with more traditional services to deliver tailored services to more market segments at far lower cost than that historically associated with traditional approaches alone." This latter development has the potential to deliver the cost savings associated with the robo-adviser model to an even broader swath of the public.

**How will the rule benefit small savers?**

Far from being harmed, those with modest incomes and low dollar balances in their retirement accounts stand to benefit most from the proposed rule. Because they are disproportionately served by broker-dealers and insurance agents who are not currently required to serve their customers' best interests, small savers are at greatest risk of receiving conflicted advice that drains their retirement savings. This is money that these individuals desperately need if they are to afford an independent and secure retirement. The revised rule offers these small account holders the flexibility of paying for retirement advice through commissions and other sales fees without forcing them to give up their right to best interest recommendations. As such, it would provide them with the same protections that the typically wealthier investors who invest through fee-based advisers already receive under the securities laws.

All savers should receive an additional indirect benefit from the rule's potential to encourage competition among investment products based on the best interests of the customer rather than

compensation to the adviser. Promoting market competition on terms that benefit, rather than harm, advice recipients can be expected to drive down costs to all retirement savers.

**I've heard the rule would put small firms out of business. Is that true?**

While firms of all sizes will have to adjust their business practices to comply with the rule, there is no valid basis for the claim that small firms would be put out of business. For small firms, the key to compliance will be the initial selection of the product menu they offer to retirement savers to ensure that it comports with a best interest standard. Firms that already offer a mix of reasonably priced, high quality investment options that allows for creation of a diversified portfolio should see relatively little impact from the rule. They would have to enter into a contract with clients, make best interest recommendations, and provide disclosures with regard to costs and conflicts, but their business could otherwise continue largely unchanged. Those whose business is built around the sale of a few high-cost, low-quality products will face a more significant change to come into compliance, but that is appropriate. Either the sponsors of the investment products they recommend will have to adjust their products to make them more competitive under a best interest standard, or the firm will have to consider changing its product mix or, in the case of high-cost products, rebating fees that don't meet the reasonableness standard. While firms are likely to see some increase in compliance cost, including the cost associated with new disclosures, investment advisers who serve the small saver market under a fiduciary standard have shown that it is possible to serve this market affordably.

**Won't the rule increase advisers' liability costs?**

Some have suggested that the rule would leave advisers vulnerable to lawsuits anytime their customers lose money on an investment or make less than they could have if they had invested differently. This is patently absurd. The rule makes clear that recommendations are assessed for compliance with the best interest standard based on the circumstances prevailing at the time of the recommendation and not on the outcome of that recommendation. As a result, an individual who sought to bring a case on the flimsy grounds cited above would be unlikely to find an attorney willing to represent them. Another significant limitation on firms' liability exposure is the inclusion of language in the rule reaffirming existing FINRA policy with regard to arbitration of claims. Under the rule, firms would still be permitted to include pre-dispute binding arbitration clauses in their contracts but not to force customers to sign away their right to participate in class action lawsuits, just as they are today. As a result, the vast majority of claims would be heard in the industry-run arbitration forum rather than in court.

Other features of the rule are likely to reduce firms' liability risks. As FINRA CEO Rick Ketchum recently stated in a letter to members, firms actually reduce their regulatory risk when they put their customers' interest first and alleviate conflicts. By requiring firms to take concrete steps to eliminate practices that encourage bad conduct, the DOL rule proposal achieves what FINRA only suggests. As a result, firms that take seriously their obligation to mitigate conflicts and put the interests of customers first should see their liability risks reduced as a result of the better outcomes they achieve for clients. The threat of litigation should therefore serve to encourage compliance without raising the specter of excessive liability exposure.

**Will the rule prohibit sales of in-house products?**

No. The rule permits the sale of in-house products subject to the conditions of the "best interest contract exemption." If an impartial expert would deem the in-house product to be in the best interest of the investor and if the fees are reasonable, advisers would be free to recommend them to retirement savers. In-house products that already meet these standards would therefore be unaffected

by the rule. Those that don't currently meet these standards would have to adjust or risk losing market share.

Where a firm's product menu consists entirely of a limited menu of in-house products, additional requirements would apply. In such circumstances, the firm would have to make a written finding that the limitations do not prevent the adviser from providing advice that is in the best interest of the retirement investors. Payments received for the services could not exceed the fair market value of the services provided, a more specific determination than is required under the best interest contract exemption's reasonable fees requirement. Before making recommendations, the firm would have to provide clear notice of any limitations placed by the firm on the investments offered by the adviser. And the adviser would have to notify the customer if their product menu did not include options that meet that individual's needs. These are reasonable precautions to address the particular risks associated with this business model.

**Will the rule prohibit sales of annuities?**

No. Annuities are on the list of products advisers would be free to recommend under the terms of the best interest contract exemption. Where an annuity is in the best interest of the retirement saver and the costs are reasonable, the adviser who otherwise complies with the terms of the best interest contract exemption would be free to recommend that annuity. Sales outside of retirement accounts, which is where one would expect the bulk of variable annuity sales to occur, would also be unaffected.

**Will mutual fund companies and financial firms still be able to offer investor education materials without being regulated as fiduciaries?**

Yes. The rule draws a clear distinction between advice, which is subject to a fiduciary duty, and investor education, which is not. The key distinction is whether the information includes a specific investment recommendation that the retirement saver can reasonably be expected to act upon, in which case it is regulated as advice and subject to a fiduciary duty. As long as an adviser is providing general information and not a specific investment recommendation, the provision of information will not be treated as fiduciary advice under the rule. That is true regardless of who provides the information or the form in which the information and materials are provided.

**Will the rule put call centers out of business?**

Firms that use call centers to provide routine account services and investor education would be unaffected by the rule. There are clear carve-outs for both types of activities in the definition of investment advice. The rule would only affect call center operations in the narrower circumstances that call center personnel actually offer investment advice. In those cases, the call centers would have to adjust their practices to comply with the best interest contract exemption, but even so there is no basis for the concern that they would be put out of business.

There is good reason, moreover, to ensure that investment advice offered through call centers is covered by the rule. A 2013 report by the Government Accountability Office (GAO) provides alarming evidence of the tactics that call centers engage in to encourage workers to roll over their 401(k) plan savings into IRAs. GAO investigators found that call center staff often make recommendations with only minimal knowledge of a caller's financial situation. Investors may also receive "cold calls" pressuring them to roll over their savings and offering them various incentives to do so. In many if not most of these situations, this conflicted advice profits the call center staff and the firms that they work for, to the customer's detriment. A firm that operates according to such a

harmful business model will have to substantially change its practices. That should be viewed as a feature, not a flaw, in the rule. As President Obama said recently, “If your business model rests on bilking hard-working Americans out of their retirement money, then you shouldn’t be in business.”

**Won’t the compliance costs on industry outweigh any benefits to retirement investors?**

Using information from industry surveys, the DOL estimates that the compliance cost associated with the proposal will total between \$2.4 billion and \$5.7 billion over 10 years. Those estimated costs pale in comparison to the significant benefits that this proposal will provide. By limiting or mitigating advisers’ conflicts, the new proposal will encourage competition based on the best interests of the investor rather than compensation to the adviser. Investment products that can’t currently compete based on quality will have to adjust or risk losing market share. Market competition based on cost and quality should dramatically reduce both the excessive fees and the inferior investment performance associated with conflicted advice. Investors and sponsors of high-quality, low-cost products should both benefit from this approach.

Because of limitations of the literature and available evidence, only some of the potential gains can be quantified with confidence. Focusing only on how load shares paid to brokers affect the amount that IRA investors holding load mutual funds pay and the returns they achieve, the proposal has the potential to deliver gains of between \$40 billion and \$44 billion over 10 years just to these IRA investors. The potential gains to the entire retirement market are likely to be much greater. However, if only 75 percent of anticipated gains to IRA investors were realized, that would amount to between \$30 billion and \$33 billion over 10 years. If only 50 percent were realized, that would total between \$20 billion and \$22 billion over 10 years. Even under the most conservative estimates, therefore, the benefits to investors of best interest advice are many times greater than the costs to industry of complying with this rule.

**Broker-dealers are already extensively regulated by the SEC and FINRA. Aren’t existing regulations adequate to protect all investors, including those saving for retirement?**

The SEC and FINRA play an important role in protecting investors, including those investing for retirement, but there are significant gaps and weaknesses in that regulatory regime. The tens of billions of dollars that retirement savers lose each year as a result of conflicted advice stems from conduct that is permissible under the rules and laws overseen by the SEC and FINRA. Specifically, while broker-dealers market themselves as trusted advisers, it is still permissible for them to favor their own interests over the interests of their customers when recommending securities, as long as the investment is generally suitable. This falls well short of the protection retirement savers reasonably expect when they turn to someone for advice. While the SEC has the authority to reduce that harm by strengthening the standards that govern broker-dealers when they provide investment advice about securities, it has failed to act on that authority. In other areas, including the recommendation of insurance products and recommendations to retirement plans, the SEC and FINRA have no authority. Investors need both the SEC and DOL to act to ensure that they are adequately protected when they rely on financial professionals for advice. It is unfortunate that the SEC has lagged so far behind in providing those protections.

**Shouldn’t the SEC, rather than DOL, take the lead in setting standards for retirement advisers?**

While the SEC is responsible for regulating securities professionals, the DOL has primary responsibility for protecting retirement assets, including by setting standards for those who provide investment advice with regard to retirement assets. When Congress adopted ERISA, it gave DOL



sole rulemaking authority under the statute. DOL also has sole responsibility for interpreting the Internal Revenue Code (IRC) prohibited transaction provisions, which specifically apply to IRA investment advice. In the more than forty years since ERISA became law, the DOL's "role in interpreting those provisions has become well established under law and in practice." The SEC, on the other hand, has no authority to interpret the Internal Revenue Code provisions. It also has no authority with regard to non-securities retirement investments. It is therefore incumbent on the DOL to use its authority under ERISA and the Internal Revenue Code to protect retirement savers from harmful adviser conflicts. Based on the proliferation of IRA assets and the compelling evidence of adviser conflicts in the current IRA market, "the special protections in the IRC Prohibited Transactions are even more critical today than when Congress first enacted ERISA more than 40 years ago."

### **Shouldn't the DOL wait for the SEC to act so that the standards can be harmonized across all types of accounts?**

When Congress enacted ERISA, it intentionally set a higher standard for protecting retirement assets than applies to other investments. There are good reasons to do so. Retirement assets are special, as evidenced by the fact that they are heavily subsidized by the government through the tax code. IRAs were subsidized by \$16 billion in 2014. However, as the RIA explains, "this figure drastically understates the degree to which current IRA savings have been subsidized by taxpayers. Because most of the savings flowing into IRAs comes from rollovers primarily from job-based retirement plans, much of the savings currently in these plans may eventually be rolled over into IRAs." The tax preference for defined contribution plans amounted to \$45 billion in 2014. These tax subsidies should flow to individuals, not financial firms, and should not be depleted by conflicts of interest.

Furthermore, there is no assurance that the SEC will act to strengthen protections for investors who receive investment advice from broker-dealers. The SEC has been considering action for nearly a decade with no evidence of concrete progress. While recent statements of support from SEC Chairman Mary Jo White are encouraging, there is still no clear roadmap or timeline for finalizing a rule. The process could take years. Meanwhile, the current inconsistent standards would be perpetuated. The typically wealthier investors who invest through fee-based investment advisers would continue to receive fiduciary protections, while the small savers who are more typically served by commission-based broker-dealers and insurance agents would not.

### **Will the DOL rule conflict with securities laws?**

Despite the different regulatory frameworks under which the two agencies operate, the DOL took great pains to draft its fiduciary rule to work in harmony with securities laws. The definition of investment advice proposed by DOL is virtually identical to the securities law definition. The best interest contract exemption deals directly with several issues that SEC would need to address if it adopted rules under Section 913 of the Dodd-Frank Act, including how fiduciary protections would apply to one-time advice, sale of proprietary products, and sale from a limited menu of products. The approach proposed by DOL is consistent with the provisions of Dodd-Frank. The DOL rule also deals very effectively with the question of how to mitigate conflicts of interest under the broker-dealer business model, a topic SEC has yet to take up despite a clear mandate in the Dodd-Frank Act to do so. This doubtless reflects the extensive consultation that has taken place between DOL and the SEC to ensure that the revised proposal would not conflict with the securities laws. The DOL explains that a key goal of the consultation was to ensure that compliance with the new proposal would not cause a regulated entity to be out of compliance with the securities laws. And, in the DOL's view,

“the current proposed regulation neither undermines nor contradicts the provisions or purposes of the securities laws.”

**If retirement savers are confused, why not just improve disclosures? Wouldn't that achieve the same result at a lower cost?**

As the DOL discusses at length in its Regulatory Impact Analysis, available academic and empirical evidence strongly suggests that disclosure alone is ineffective at mitigating conflicts in financial advice. First, extensive evidence demonstrates that a majority of retail investors are incapable of adequately understanding the implications of disclosed conflicts and factoring that understanding into their choice of adviser and investments. Furthermore, most retail investors are unlikely to have the financial sophistication necessary to check the quality of advice and detect adviser misbehavior. Many if not most investors also are likely to ignore disclosures. For example, the RIA cites the 2008 Rand Study that interviewed representatives of brokerage firms who reported extensive efforts to clearly disclose conflicts. Several acknowledged that “investors rarely read these disclosures...[F]or many investors, the fact that they were given disclosures was seen as meaningless.”

There is even evidence that conflict disclosures can have a harmful impact on investors. Behavioral economists have found that, where investors are able to pay attention to and understand disclosures regarding adviser conflicts, they still may react to disclosures in ways that exacerbate the harms that can result from these conflicts. For example, they might interpret conflict disclosures as a sign of honesty or high professional standing, or feel socially constrained from questioning their adviser's integrity or threatening their livelihood. And, their adviser may feel “morally licensed” to pursue their own interests over their customers' interests after having warned them of their conflicts. One legal academic who has surveyed the literature of broker obligations, conflicts, and disclosure concludes that, “disclosure alone is a frail tool with which to attack the many ills that arise from blatant conflicts of interest in the financial industry.”

Based on the extensive academic and empirical evidence, the DOL has rightly concluded that a rule that relies on disclosure alone to mitigate adviser conflicts would be ineffective, would yield little or no investor gains, and would therefore fail to justify the compliance cost associated with requiring increased disclosure.

**Conclusion**

Financial firms and their advisers are understandably nervous about a rule that could force them to make significant changes in the way they conduct their business. But change is necessary to ensure that retirement savers who turn to financial professionals for advice receive recommendations that promote their ability to enjoy a secure and independent retirement. The DOL has exceeded expectations in proposing a rule that carefully balances the need to strengthen protections for retirement savers with the need to allow compliance under a variety of business models. They have done everything that industry asked of them when they withdrew their 2010 proposal: they produced a comprehensive economic analysis showing the harm to investors that justifies rulemaking; they revised the rule to reflect the legitimate concerns raised by industry; and they issued the draft exemptions which are crucial to understanding how the rule will be applied in practice. They did all that while enhancing the rule's protections for retirement savers. While the rule will doubtless undergo some fine-tuning as a result of the comment process, this is a strong proposal that deserves all of our support.



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April 12, 2011

Employee Benefits Security Administration  
Office of Regulations and Interpretations  
Attn: Public Hearing on Definition of Fiduciary  
Room N-5655  
U.S. Department of Labor  
200 Constitution Avenue NW  
Washington, DC 20210

Dear Sir or Madam:

We are submitting the attached study prepared by Oliver Wyman Inc. (the "Study") with respect to the Department of Labor's proposed definition of a fiduciary.

As you will see, the Study is a unique broad-based examination of the effect of the proposed regulation on IRAs. The firms participating in the Study collectively represent over 19 million IRA owners who hold \$1.79 trillion in assets through 25.3 million IRA accounts. This constitutes approximately 40% of IRAs in the United States and 40% of IRA assets.

We believe that the Study can play a key role in the public policy discussion regarding the proposed regulation. It is critical that the Department and the private sector work together, based on this Study and other comments, to ensure that any new rules enhance retirement security. In that regard, it is very important that all rules related to the proposed regulation, such as prohibited transaction class exemptions, be developed and finalized contemporaneously with the proposed regulation.

The results of the Study, as summarized below, are of great concern. However, it is our hope that working together, the Department and the private sector can find solutions that address these concerns.

Set forth below is the Study's "Summary of key findings":

**IRAs are the fastest growing accounts holding retirement savings.**

**IRAs are widely held by small investors.**

- Nearly 40% of IRAs in the study sample had less than \$10,000.

**Small investors overwhelmingly favor brokerage relationships over advisory relationships.**

- 98% of accounts of investors with \$25,000 or less in their IRAs were in brokerage relationships.

**The proposed rule could eliminate access to meaningful investment services for over 7 million individuals.**

- IRA investors would no longer be able to receive investment services and help as part of a brokerage relationship.
- Because of account minimums, 7.2 million current IRAs would not qualify for an advisory account with any firm in the study.

**The proposed rule could well result in hundreds of thousands of fewer IRAs opened per year.**

- In 2010, firms in the study sample opened approximately 890,000 brokerage IRA accounts with assets of less than \$10,000.
- Under the proposed rule, small investors interested in opening an IRA would have less access to investment professionals, making it less likely that they would open an IRA.

**Many IRA holders would have reduced choice of investment professional, as over one-third of client-facing financial professionals in the industry would not be licensed to help retail investors with their IRA account needs under the proposed rule.**

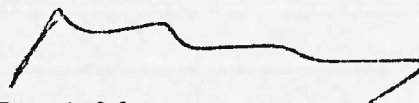
**The brokerage IRA investors who could be served in an advisory model would likely face increased costs as a result of the rule-driven change.**

- In the study sample, estimated direct costs would increase by approximately 75% to 195% for these investors.

\* \* \*

Thank you for the opportunity to comment.

Sincerely,



Kent A. Mason

April 12, 2011

**Oliver Wyman report: Assessment of the  
impact of the Department of Labor's proposed  
"fiduciary" definition rule on IRA consumers**

**OLIVER WYMAN**

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## **About this study**

On behalf of a group of 12 financial services firms that offer services to retail investors, Davis and Harman LLP engaged Oliver Wyman to analyze the impact on Individual Retirement Account (IRA) investors of the Department of Labor's proposed change to the rule defining a "fiduciary" for purposes of the Employee Retirement Income Security Act of 1974 ("ERISA") and section 4975 of the Internal Revenue Code of 1986, as amended (the "Code").

The firms participating in this study collectively represent over 19 million IRA holders who hold \$1.79 trillion in assets through 25.3 million IRA accounts. This constitutes approximately 40% of IRAs in the United States and 40% of IRA assets. Due to the highly sensitive nature of firm-specific information, all data is presented in aggregated form in this report.

In particular, Oliver Wyman was asked to evaluate the potential impact, if enacted, of the proposed rule change on smaller retail IRA investors with respect to:

1. access to investment help and services from a licensed investment professional,
2. choice of investment professional, relationship model in terms of commission-based brokerage versus single fee, "wrap" investment advisory accounts, as well as breadth of product choice, and
3. cost impact to IRA holders.

## **Summary of key findings**

**IRAs are the fastest growing accounts holding retirement savings.**

**IRAs are widely held by small investors.**

- Nearly 40% of IRAs in the study sample had less than \$10,000.

**Small investors overwhelmingly favor brokerage relationships over advisory relationships.**

- 98% of investor accounts with less than \$25,000 were in brokerage relationships.

**The proposed rule could eliminate access to meaningful investment services for over 7 million IRAs.**

- IRA investors would no longer be able to receive investment services and help from an investment professional as part of a brokerage relationship.
- Because of account minimums, 7.2 million current IRAs would not qualify for an advisory account with any firm in the study.

**The proposed rule could well result in hundreds of thousands of fewer IRAs opened per year.**

- In 2010, firms in the study sample opened approximately 890,000 brokerage IRA accounts with assets of less than \$10,000.
- Under the proposed rule, small investors interested in opening an IRA would have less access to investment professionals for guidance and support, making it less likely that they would open an IRA.

**Many IRA holders would have reduced choice of investment professional, as over one-third of client-facing financial professionals in the industry would not be licensed to help retail investors with their IRA account needs under the proposed rule.**

**The brokerage IRA investors who could be served in an advisory model would likely face increased costs as a result of the rule-driven change.**

- In the study sample, estimated direct costs would increase by approximately 75% to 195% for these investors.



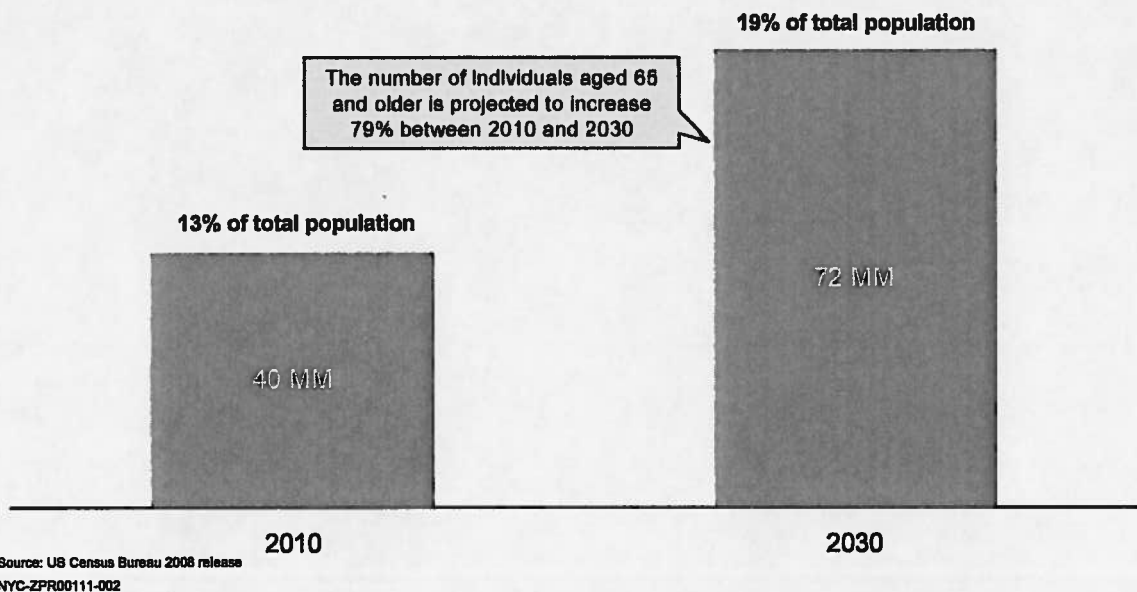
## 1. The outlook for U.S. retirement savings and the role of the IRA

*Personal retirement savings are an essential part of funding the future retired population*

As is well documented in numerous studies, the U.S. population is aging. The number of retired Americans aged 65 or over is projected to swell nearly 80% to 72 million by 2030 compared to 40 million today.

### Figure 1: The U.S. population is aging

Increase in the 65 and over population, 2010 – 2030



At the same time, Americans increasingly need to take on far more proactive personal planning for their own retirement income. Former support mechanisms such as employer-sponsored defined benefit pension plans are disappearing (over 65% of individuals with an employer-sponsored retirement plan were in a defined benefit pension plan at the end of the 1980s, compared with only 36% of individuals by the mid 2000s<sup>1</sup>). Furthermore, the Social Security system is coming under increasing stress amid U.S. funding and budgetary issues as the population skews towards older individuals in the savings decumulation period of their lives.

We estimate total personal financial assets in the U.S. today amount to \$53 trillion, of which \$40 trillion can be considered investable.<sup>2</sup> As Figure 2 shows, the growth outlook for many of the major asset classes is challenged, which we expect will increase the

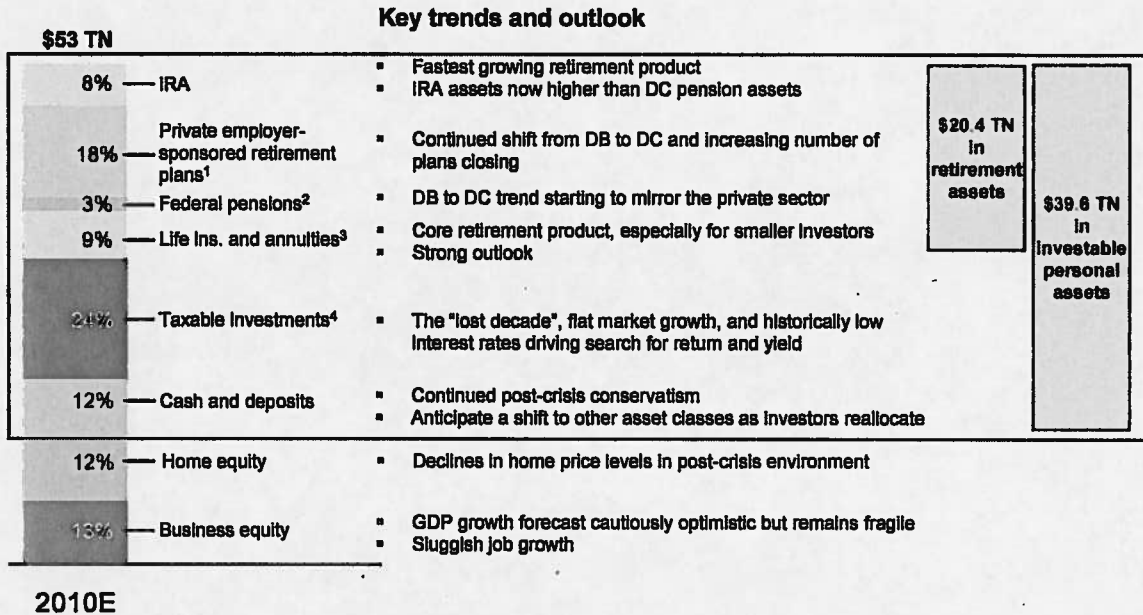
<sup>1</sup> ICI, 2009, EBRI Databook

<sup>2</sup> Oliver Wyman analysis, Federal Flow of Funds, Cerulli, American Council of Life Insurers

importance of personal retirement savings. Of the total, approximately \$20.4 trillion constitute specific retirement assets in the form of IRAs, pensions, life insurance and annuities.

**Figure 2: Retirement assets constitute ~\$20 TN of the total \$40 TN of investable personal financial assets in the U.S.**

U.S. personal retirement assets, year-end 2010



Source: Oliver Wyman analysis, Federal Flow of Funds, Cerulli, American Council of Life Insurers

1. Includes public sector DB plans and DC plans (Taft-Hartley, 403(b), 457), and private sector DB and DC plans (401(k), money purchase plans, profit sharing plans, Keoghs); category excludes those assets invested in annuities to avoid double-count

2. Includes Federal DB plans (Civil Service Retirement Systems, FERES, Military Retirement Fund, National Railroad Retirement Trust, Railroad Retirement Board) and DC plans (Federal Thrift Savings Plan); excludes Social Security

3. Includes general and segregated funds held on behalf of US policyholders and annuitants; excludes life insurance reserves

4. Includes Corporate equities, Mutual Fund Shares, Money Market Fund Shares, Credit market instruments less IRAs

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*IRAs are a critical and rapidly growing part of U.S. retirement savings*

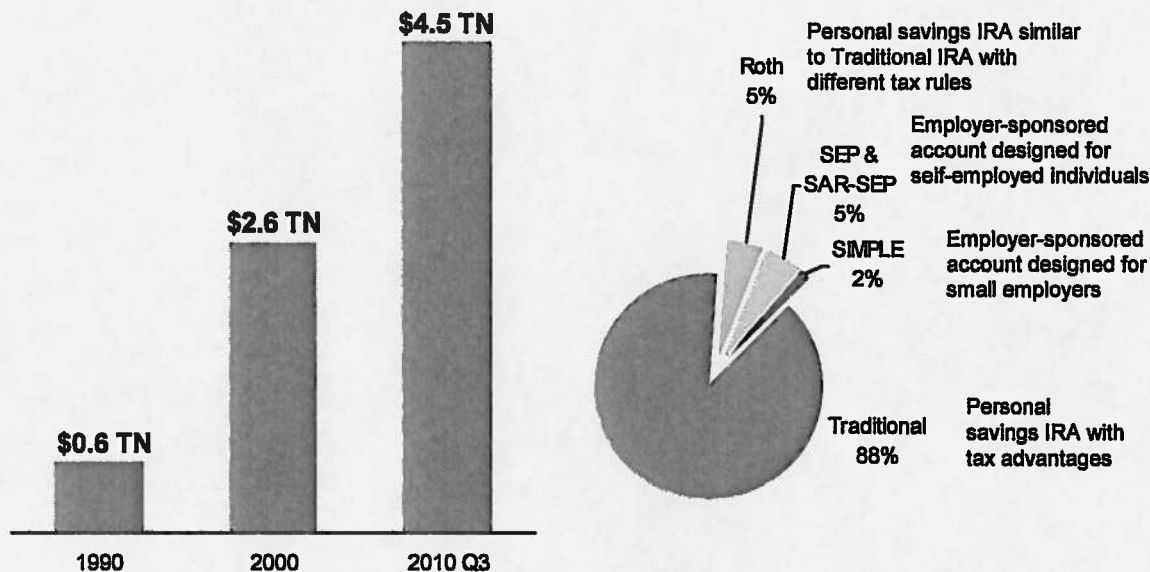
Since their introduction in 1974, IRAs have grown to represent around 8% of total personal financial assets in the U.S. today<sup>3</sup>, representing \$4.5 trillion. 49 million U.S. households hold an IRA and for 8% of households IRAs represent the only form of retirement savings.<sup>4</sup> IRAs are the fastest growing investment accounts holding retirement savings and have become an ever more important part of U.S. households' future funding, increasing from 16% of retirement market assets to 27% in the 20 years from 1990 to 2010.<sup>5</sup>

<sup>3</sup> Federal Flow of Funds, Cerulli, American Council of Life Insurers, Oliver Wyman Analysis

<sup>4</sup> ICI, Research Fundamentals, 2010

<sup>5</sup> ICI, The U.S. Retirement Market for Q3 2010, released 2011

**Figure 3: IRAs are growing rapidly with traditional IRAs continuing to dominate<sup>6</sup>**  
 IRA growth and distribution by type, 1990 – 2010



Source: ICI Q3 2010, Cerulli 2009 Retirement Markets, Oliver Wyman estimates  
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As a tax-advantaged savings vehicle, IRAs play a critical role in private savings. Subject to certain conditions, IRAs enable investors to retire with more wealth than if they had invested through a taxable account. Similarly, IRAs help eliminate distortions in asset allocation and investment risk by allowing investors to defer taxes on investment income, thereby leveling the field between capital gains-oriented equities and income-generating investments such as bonds and dividend-paying stocks. Finally, IRAs and other tax-deferred products enable investors to make optimal portfolio rebalancing decisions independent of tax considerations.

*The retail financial services industry currently offers a range of relationship models in response to the diversity of investor needs*

With investment savings, like many things, the most difficult step is often the first one, and many retail investors seek support from a financial advisor and/or brokerage firm serving as an IRA custodian to help them through the technical, and largely tax-driven requirements of setting up and funding an IRA through cash contributions or rolling money over from an existing qualified retirement plan. Opening a retirement account is

<sup>6</sup> Source: ICI Q3 2010, Cerulli 2009 Retirement Markets, Oliver Wyman estimates

just the beginning, however. It takes personal discipline to remain on track, and investors need to continue to make regular contributions to their account over a long time period in order to benefit from compounded growth of their investment savings.

Investors seek a wide range of assistance – from more basic tax information and asset allocation modeling to sophisticated, investment-specific guidance from investment professionals. Two primary IRA business models have evolved to serve all investor types. These two primary channels through which individuals access IRA savings accounts are summarized in Figure 4 and described in further detail below.

**Figure 4: There are two main IRA business models today**

**Key attributes of IRA business models**

Key Attributes	Advisory	Brokerage	
		Full service	Discount
<b>Investment services needs</b>	<ul style="list-style-type: none"> <li>▪ Broad financial planning and investment advice</li> </ul>	<ul style="list-style-type: none"> <li>▪ Product-specific investment information, access to principally-traded products and range of third party and proprietary products</li> </ul>	<ul style="list-style-type: none"> <li>▪ Product-specific investment information, access to principally-traded products and range of third party and proprietary products</li> </ul>
<b>Level of service</b>	<ul style="list-style-type: none"> <li>▪ Personalized access to an investment professional</li> <li>▪ Highest ongoing advice and account surveillance</li> </ul>	<ul style="list-style-type: none"> <li>▪ Personalized access to an investment professional</li> <li>▪ Information to help investors set up an IRA account and select suitable investments</li> </ul>	<ul style="list-style-type: none"> <li>▪ Often offer access to an investment professional through a branch or call center</li> <li>▪ Online investment information, research, tools and calculators to help investors set up an IRA account and select suitable investments</li> </ul>
<b>Cost</b>	<ul style="list-style-type: none"> <li>▪ Tends to be highest cost</li> </ul>	<ul style="list-style-type: none"> <li>▪ Balanced cost, with costs based on level of trading activity</li> </ul>	<ul style="list-style-type: none"> <li>▪ Lowest cost, depending on trading activity</li> </ul>

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**Advisory IRAs** offer ongoing advice that may include investment-specific advice, portfolio monitoring, and account surveillance to determine both product-level investment suitability and account make-up. Advisory IRAs involve a relationship with a Registered Investment Adviser (RIA) or dual-registered broker-dealer/RIA. Fees on such IRA accounts are virtually always structured as a “wrap” fee (i.e. an annual client charge of a percentage of account assets).

Brokerage IRAs are offered today in two ways:

- **Full service brokerage IRAs**, in which an investor makes investment decisions, and has regular access to a registered broker representative, plus a range of investment solutions. This typically involves non-continuous, point-in-time help and investment services. In this approach, the brokerage firms are compensated through transaction-specific direct commissions, annual account fees, and various “indirect” sources of compensation (such as marketing and distribution fees paid by mutual funds).
- **Discount brokerage IRAs**, in which an investor makes investment decisions with more limited personal contact (which may occur at a branch or call center), and which often have a full suite of tools to help investors evaluate investment products and transact online. Discount brokerage relationships often have reduced transaction-specific direct commissions, account fees, and indirect compensation.

These two IRA channels have different service models, with different underlying cost structures. Fee-based advisory IRAs involve a number of services that are not present in either of the brokerage channels, such as:

- Ongoing fund and manager research
- Ongoing account surveillance
- Detailed investment performance modeling
- Formalized asset allocation modeling
- Ability for the financial advisor or the firm to utilize discretion with respect to the accounts (a feature in most advisory programs)

Offering these services to advisory investors involves higher costs to the provider, reflecting the required technology investment and compensation for the time financial advisors and support personnel need to spend on each account. In addition, pricing of advisory relationships must reflect the overall liability risk of such relationships. Pricing for the different IRA channels reflects these different underlying cost structures. Accordingly, fee-based advisory IRAs generally represent the highest service level and cost channel for investors.

## **2. Proposed changes to IRA regulation**

In October 2010, the U.S. Department of Labor's Employee Benefits Security Administration announced a proposed rule change to the definition of “fiduciary investment advice” for ERISA-covered qualified retirement plans and IRAs. The proposed change would greatly expand the range of conditions under which an individual who merely provides investment services in a brokerage context would be subject to ERISA fiduciary rules. After receiving a significant amount of public commentary about

the proposed change, the Department of Labor held public hearings on March 1 and 2, 2011, and subsequently opened a 15-day window to receive additional comments.

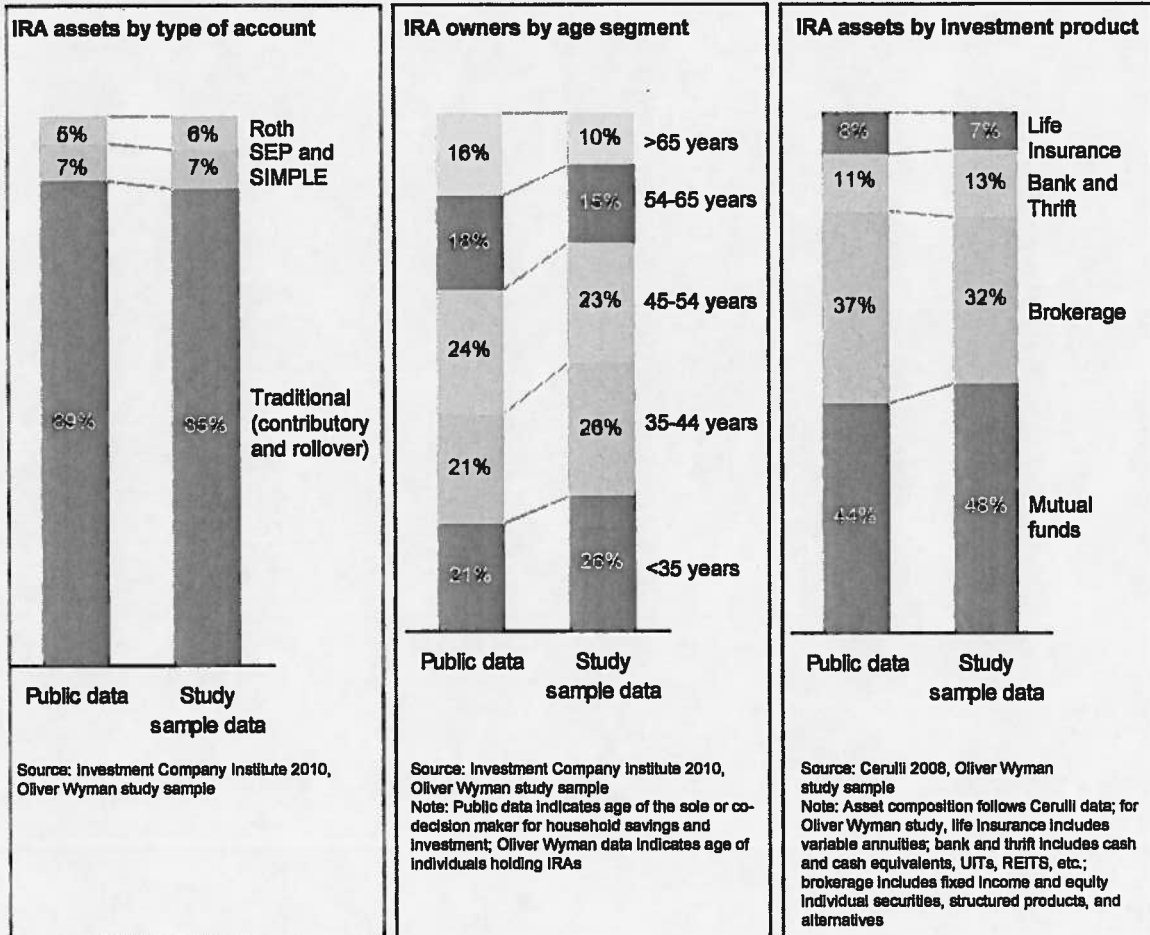
Given the magnitude of potential change for both investors and providers, and a lack of sufficiently granular publicly-available data, Davis and Harman LLP engaged Oliver Wyman on behalf of a group of 12 financial services firms offering retail investment services to analyze the potential impact of the proposed rule on IRA investors. The group of firms participating in this study contributed proprietary firm-level data on their IRAs to create a large sample of IRA market participants. In particular, Oliver Wyman was asked to use the aggregated dataset to analyze the proposed rule with respect to its potential impact on investors' access to investment services and help; investors' choice of relationship model, advisor, and product set; and investors' cost of service.

*The study sample in this report provides a unique window onto today's IRA investors, as well as the distribution of key account characteristics such as size and type of account*

The aggregate study sample provides an unprecedented view into the range of IRA account characteristics. The participant group in this study represents 40% of both total IRA assets and number of accounts in the U.S. A comparison with publicly available data suggests that the sample broadly mirrors the entire IRA market in type of IRAs held, age of IRA holders, and asset allocation.

**Figure 5: The study sample data appears to be highly representative of the total U.S. IRA investor population**

**Comparison of study sample data to total U.S. IRA population**



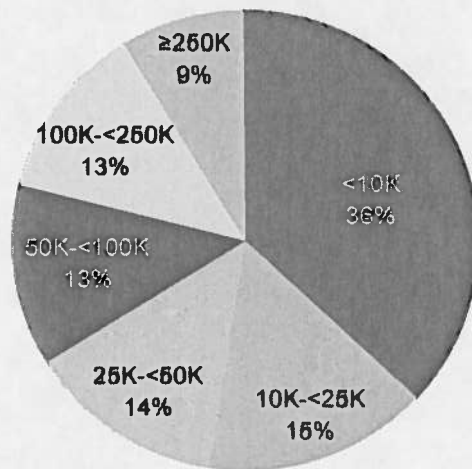
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Note that due to limitations in some firms' data, specific analyses may be based on substantial subsets of the entire study sample.

### 3. IRA investment behavior of smaller investors

As shown in Figure 6, approximately half of IRA investors in the study sample have less than \$25,000 in IRA assets, and over a third have less than \$10,000.

**Figure 6: The majority of IRA account holders have lower asset levels**  
IRA account holders by total IRA asset size segment, year-end 2010

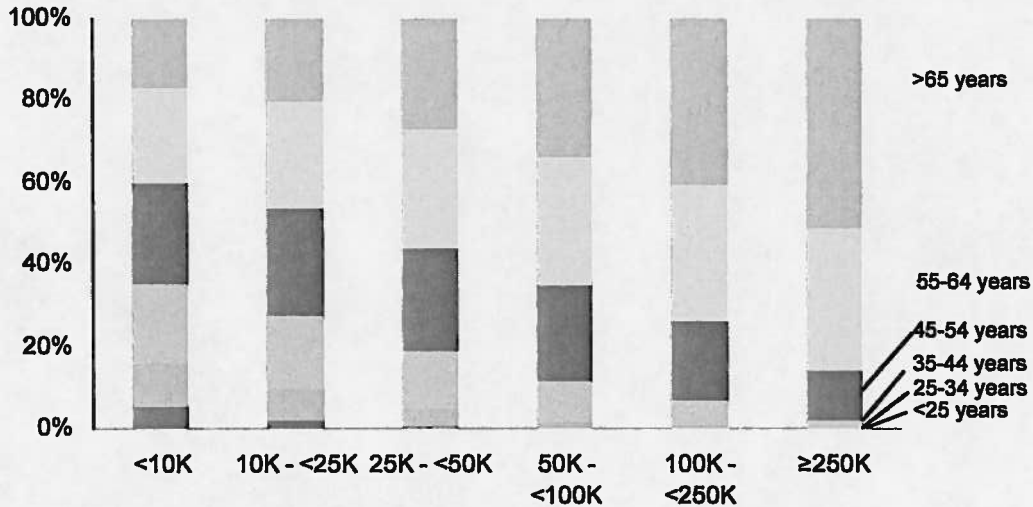


Source: Oliver Wyman study sample  
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Although some of these small investors are young and therefore only at the beginning of their savings lifetime, a significant number are also in older age brackets, highlighting the importance of the IRA as a savings vehicle to individuals in their peak savings years.

**Figure 7: Very small investors are fairly evenly distributed across age brackets**  
 IRA investor age distribution by asset size segment

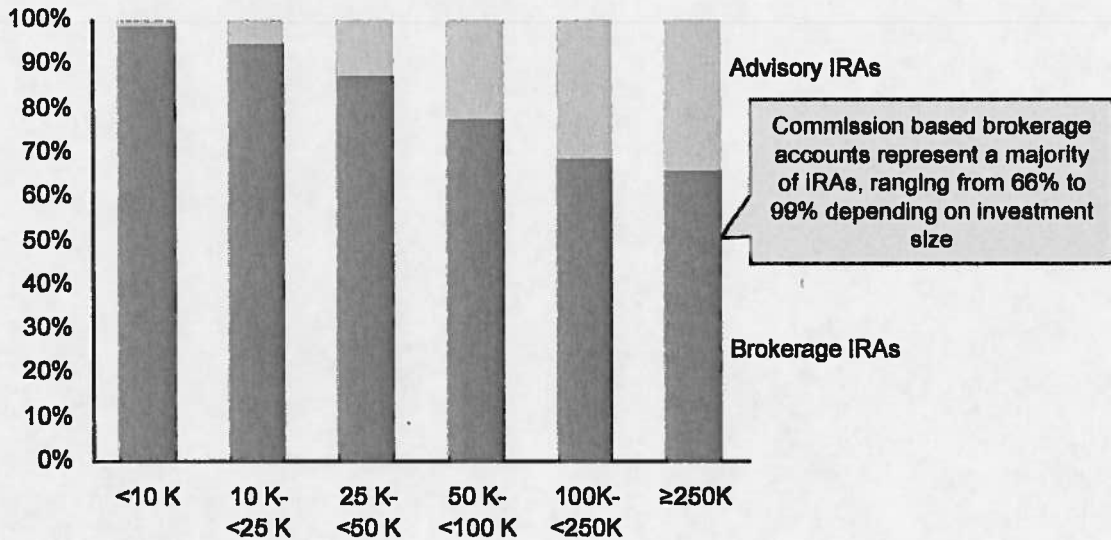


Source: Oliver Wyman study sample  
 NYC-ZPR00111-002

Investors represented in the study group overwhelmingly use the brokerage relationship model as opposed to a fee-based advisory model, with 22.4 million or 88% holding brokerage IRAs. Brokerage IRAs are more common across all account sizes analyzed, ranging from a high of 99% for accounts with less than \$10,000 to a low of 66% for investors with more than \$250,000 in their IRAs.

**Figure 8: Investors prefer transactional, commission-based brokerage accounts over asset-based fee advisory models for IRAs**

Proportion of IRAs using each relationship model by asset size segment, year-end 2010



Source: Oliver Wyman study sample  
NYC-ZPR00111-002

Of the 2.4 million new IRAs opened with study participants in 2010, nearly 1 million contained assets of less than \$10,000 by year end. Not surprisingly, these accounts also conducted fewer trades on average than larger accounts. Figure 9 shows a summary of IRA holder activity through the study group firms in 2010.

**Figure 9: Summary of IRA account holder activity**  
Year-end 2010

Investor size segment	<\$10K	10K-<25K	25K-<50K	50K-<100K	100K-<250K	≥250K	Total
Number of IRA accounts (MM)	10.1	4.2	3.4	3.0	2.9	1.6	25.3
Number of new IRA accounts opened in 2010 (MM)	0.9	0.3	0.3	0.3	0.3	0.2	2.4
Average number of trades per account	3	5	8	15	25	36	11

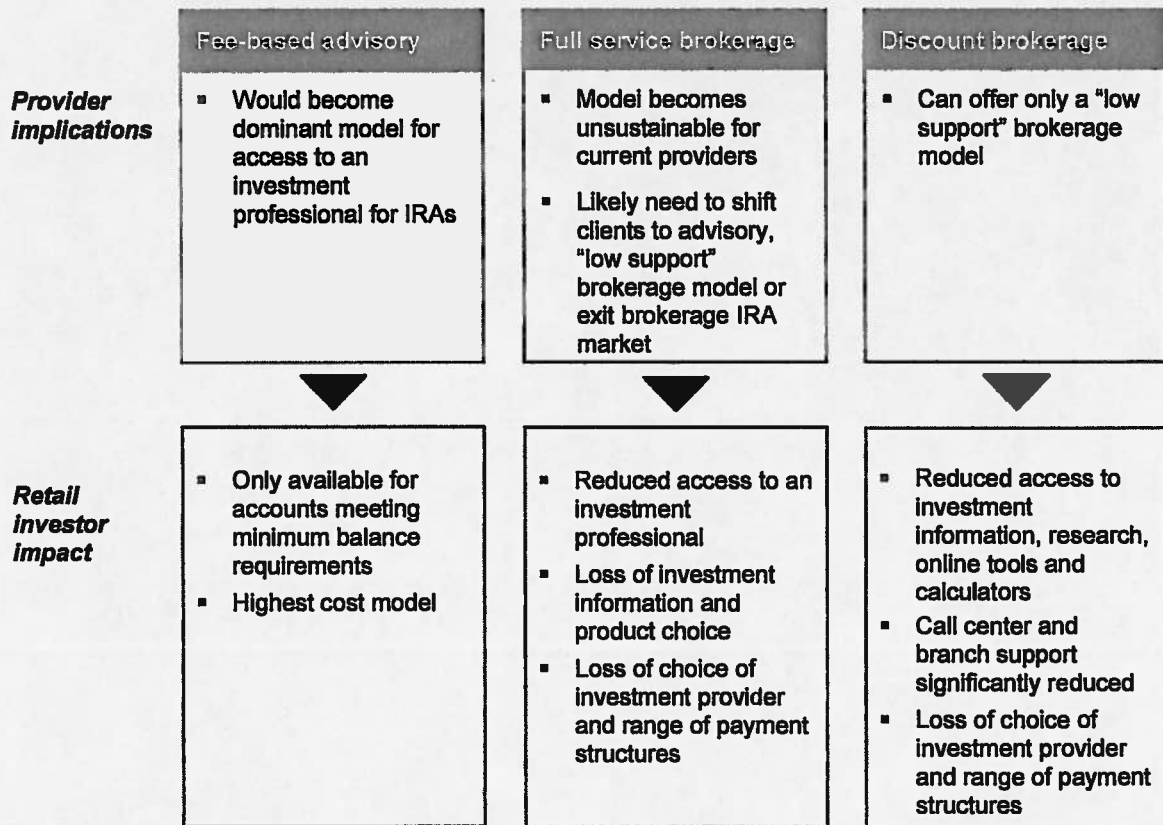
For smaller investors with low trading activity, the brokerage model with predominantly per-transaction charges may be more affordable than the advisory model

Source: Oliver Wyman study sample. Some analyses based on a sub-set of participants, depending on data availability  
NYC-ZPR00111-002

#### 4. How the rule change will reshape services for IRA investors

*Under the proposed rule, Oliver Wyman expects retail brokerage firms would presume that current brokerage account and service offerings would create a fiduciary duty, and respond by limiting the provision of help and investment services to the fee-based advisory model only*

**Figure 10: Expected financial industry response and IRA investor impact**



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Investors today who have an IRA account through a brokerage relationship receive a range of investment services and help as part of that relationship. However, the proposed rule would appear to make practically every investment-related conversation or interaction with a client subject to fiduciary duty. Interactions that could trigger a broker fiduciary duty to IRA owners under the proposed rule include:

- discussion of investments within an IRA account;

- discussions that clients have with brokers about other, non-retirement account investments if such discussions "may be considered" by the client in an IRA account as well;
- communications regarding firm-wide research on securities;
- valuations of hard-to-value assets;
- IRA "education" (if the Department of Labor does not amend the proposed rule to bring education for IRA owners clearly in scope as non-fiduciary); and
- conversations about rollovers, if the Department of Labor, as discussed in the preamble to the proposed rule, withdraws its prior guidance indicating that such conversations are non-fiduciary.

Because of the broad range of triggering interactions, as a practical matter, firms would need to assume that any IRA investor offered typical brokerage interactions and investment services would be treated as receiving fiduciary services (even if the actions described in the last two bullets do not trigger fiduciary status).<sup>7</sup> Indeed, if a registered representative is found to be a fiduciary, any transactions performed on behalf of a client could be transformed into prohibited transactions giving rise to severe sanctions (e.g. requirement that transactions be undone) and penalties to the holder. The risk of such sanctions is not one that financial firms will likely bear.

As fiduciaries under the Department of Labor's proposed rule, firms and their associated representatives may not receive different levels of compensation based on the investment choices of retail investors in protected IRA accounts. However, the current brokerage model that has developed to serve IRA accounts is incompatible with this requirement, often involving both direct and indirect fees, such as shareholder servicing fees, sales and distribution fees, revenue-sharing and other fees. These fees frequently vary by product based on factors such as complexity, advisor time requirements (e.g. to explain the risks and benefits and determine client suitability), and services performed such as shareholder servicing. As it stands, the current IRA market has developed around these pricing and risk assumption structures. It would likely be almost impossible to renegotiate myriad contracts with different product manufacturers and create a new level-fee brokerage paradigm just for IRA accounts.

Under the proposed rule, brokerage firms would likely only offer today's level of investment services and guidance to IRA investors through fee-based advisory accounts, which would also include additional services such as ongoing account surveillance required to satisfy a fiduciary duty relationship.

It may be possible for firms to preserve a brokerage IRA option, but this model would likely involve very low support. Such a service model would likely need to involve strict

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<sup>7</sup> The proposed rule would also apply an ERISA fiduciary standard to any entity that is registered as an investment advisor, generally regardless of whether the entity is actually acting in advisory capacity.

limits on baseline services such as offering investment services. Even interactions which are a common part of many discount brokerage relationships today, such as discussions with call center and branch staff, could be curtailed (so as to avoid inadvertently establishing a fiduciary duty).

In addition, some firms without a registered investment advisor may choose to exit the IRA market completely rather than incur the expense involved in setting up an investment advisor and licensing its representatives. (For example, see Figure 13.)

For investors with existing IRA accounts within a brokerage relationship model, we therefore see three potential outcomes:

- 1) Move to an advisory relationship – this will not be feasible for all affected investors, as many may be too small to serve economically as part of an advisory relationship. Indeed smaller IRA holders with low trading activity levels may experience higher fees in this model
- 2) Move to a “low support” brokerage model – this option may not be suitable or even practical for many investors, given the time and expertise needed to understand tax-advantaged investing without outside support, thus significantly impacting current and future IRA holders
- 3) Move existing funds out of the tax-advantaged retirement account market – this could have significant impacts on ultimate savings available to support the retirement of affected investors

Beyond the impact on existing IRA investors, the proposed rule would engender major long-term changes to the ways in which investment services and help could be offered to future investors. Brokerages will no longer have an economic incentive to develop relationships with investors who can only fund a small IRA balance. Instead, firms will look to offer investment services and support only to those whose larger account size can be economically served under the advisory model.

Below, we examine the number of IRA investors in our study sample that could be affected by the changes in service described above.

## **5. Impact of the proposed rule change on retail investors in the study sample**

*The proposed rule change would affect the overwhelming majority of investors who rely on brokerage IRA accounts in terms of access, choice, and affordability – this would notably disadvantage small investors*

## 5.1. Reduced access to a licensed professional advisor

*In the study sample alone, 7.2 million current retail brokerage IRAs would not qualify for an advisory account with any firm in the study*

All firms in the study have account minimums for accessing their advisory channels. At today's account minimums, 10.7 million current retail accounts would have insufficient assets to gain access to an advisory account at their current firm. Of these, 3.5 million would have sizeable enough balances for an advisory relationship but the holders would need to switch firms to find an advisory channel with a lower minimum asset requirement. Finally, 7.2 million accounts would have insufficient assets to qualify for the advisory channel at any firm.

Based on studies of consumer behavior in similar situations, we expect significant numbers of these investors would likely drop out of the IRA market. For example, we believe that a large number of small balance investors forced to switch to a new firm to access the advisory channel would be likely to take a cash distribution rather than successfully re-invest in a new IRA. We also believe that only a portion of investors who are not able to access the advisory channel at any firm will open an online IRA, given the extensive restrictions on outreach to these clients under the proposed rule.

### Box 1

#### Example long term investor impact estimation – illustrative only

*As an example of the potential impact of this proposed rule change, we have estimated a reduction in tax advantaged retirement savings over a 20 year period using high-level assumptions. Clearly, a large number of factors come into play when considering the long term evolution of retirement savings in the U.S., and this example does not attempt to factor in all of these. Rather, it is intended to provide some sense of the potential magnitude of the impacts over time. The assumptions used are clearly stated at each stage.*

As discussed in Section 4, we believe there are three possible outcomes for the 22.4 million brokerage IRAs that are included in the study sample and that would be impacted in some way by the proposed rule change:

1. We assume that each of the 11.7 million investor accounts that have sufficient assets to qualify for the advisory channel in their current firm would successfully migrate to this channel with no account holders choosing to take a distribution.
2. Prior consumer behavior studies<sup>8</sup> have analyzed investor behavior when individuals leave a workplace sponsored retirement plan. We use these as a proxy for the likely

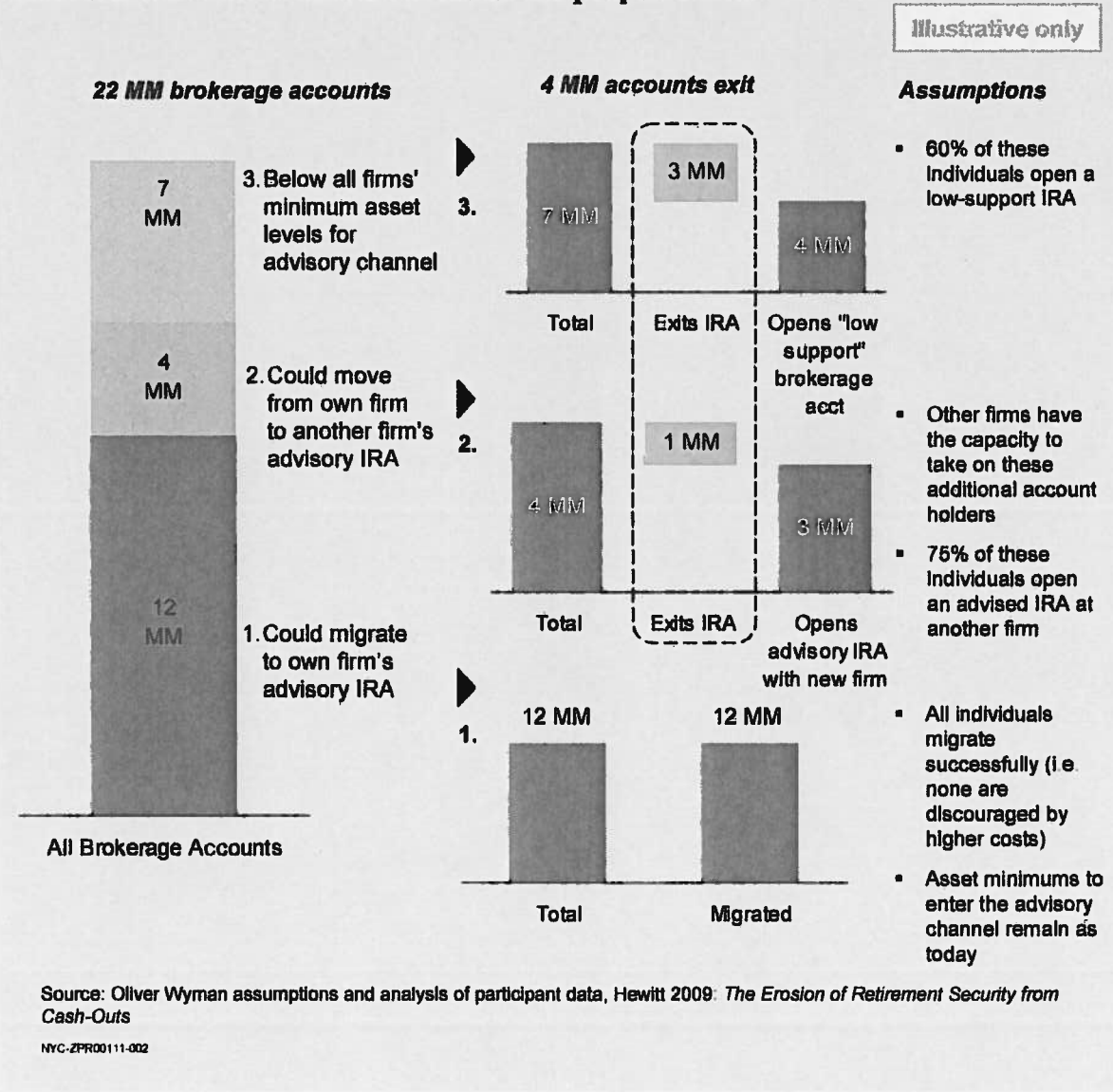
<sup>8</sup> Hewitt 2009: The erosion of retirement security from cash-outs

behavior of the 3.5 million accounts that have insufficient assets to qualify for their own firm's advisory channel but would qualify at another firm. This analysis suggests that approximately 75% may open an IRA with a new firm.

- For the remaining 7.2 million investors who do not qualify for any firm's advisory channel, we assume that 60% open an IRA in the "low support" model. We believe that there is a high probability that the number of people who successfully open a "low support" IRA would in fact be lower (i.e. less than 60%), given the significantly reduced investment services that would be allowed under the new rule in this channel.

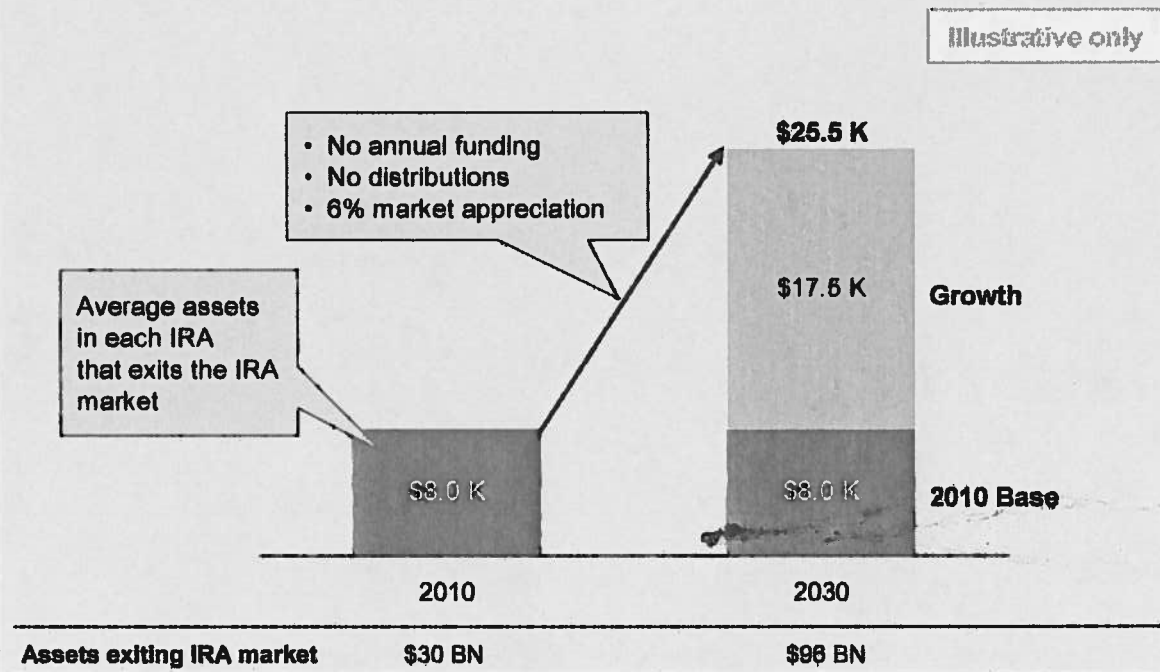
This estimation process results in 3.8 million IRA accounts exiting the retirement savings pool. This is illustrated in Figure 11.

**Figure 11: In current sample, high-level estimates suggest that 3.8 million accounts could exit the retirement market under the proposed rule**



The average assets of each IRA that exits the market would be approximately \$8,000 in this scenario. Using baseline assumptions for market appreciation as shown in Figure 12, this amount could grow to \$25,500 by 2030, suggesting a reduction of approximately \$96 BN across all IRAs that exit the market.

**Figure 12: Potential lost retirement savings of \$96 BN in accounts that exit the IRA market**



Source: Oliver Wyman study sample, Oliver Wyman analysis

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Finally, it is worth considering the impact of elimination of support from the full service brokerage model on potential future investors. In 2010, firms in the study sample opened approximately 890,000 brokerage IRA accounts with assets of less than \$10,000. If the proposed rule change were assumed to take effect at the beginning of the year and were to result in the impacts suggested in this report, we estimate as many as 360,000 brokerage IRAs would potentially no longer be opened in 2011. This estimate uses similar investor behavior assumptions to those employed for the analysis of existing small IRA account holders who would lose access to a full service brokerage model (i.e. 60% of investors would open a “low support” brokerage IRA). Given the lack of support such investors could have in navigating the complexities of opening a new IRA, we believe these are conservative assumptions. Additionally, in future years, we estimate the number of foregone new full service brokerage IRA accounts could grow to a total of approximately 8 million by 2030, assuming the number of IRA holders grows in line with population growth in the 20 plus age group.

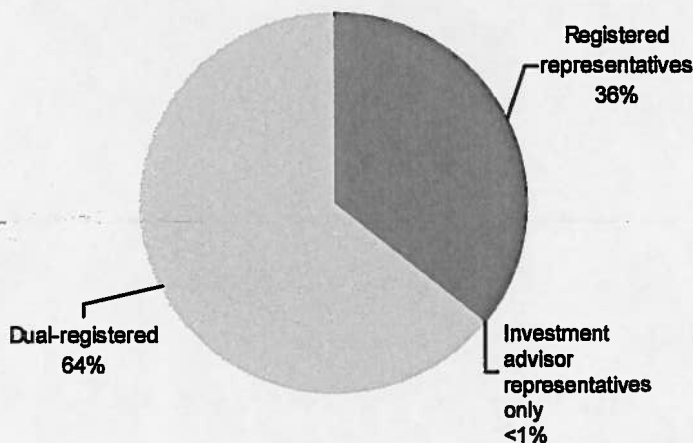


## 5.2. Reduced choice of investment professional, level of investment guidance, and investment products

*Investors will likely have reduced access to help and investment guidance as 36% of U.S. financial professionals in contact with clients are not currently licensed to help retail investors with their IRA account needs under the proposed new rule*

As Figure 13 shows, in the study sample 37,000 current investment professionals (36% of the work force) are currently registered exclusively as registered representatives of a broker dealer, not as investment advisor representatives under the Investment Advisers Act of 1940 or dual-registered<sup>9</sup>.

**Figure 13: Workforce by registration type, year-end 2010**



Source: Oliver Wyman study sample

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Existing investors who have a personal relationship with a financial professional could find themselves forced away from this individual, regardless of their preference or relationship history. Without additional training and licensing, registered broker representatives may no longer be able to provide help and investment services to retail investors seeking to open or manage an IRA account. Not all firms have both broker dealers and investment advisor representatives, however, and it may not make sense for them to incur the cost and expense of setting up an advisory channel to support IRA accounts.

*Nearly 90% of IRA investors will be impacted by the proposed rule*

<sup>9</sup> Industry-wide this number has been estimated by other studies at 317,000 due to the low number of dual-registered individuals in smaller firms

Over 22.4 million accounts and 17.6 million people in our sample have personally elected to save in an IRA account under a brokerage model. As discussed, some would be able to move to an advisory relationship. However, the remainder will lose the benefits of working with a financial professional and be forced to migrate to a purely “low support” brokerage model to continue their IRA retirement savings with little access to investment services, research and tools.

*Investors will lose access to a range of product types found predominantly in brokerage IRAs today*

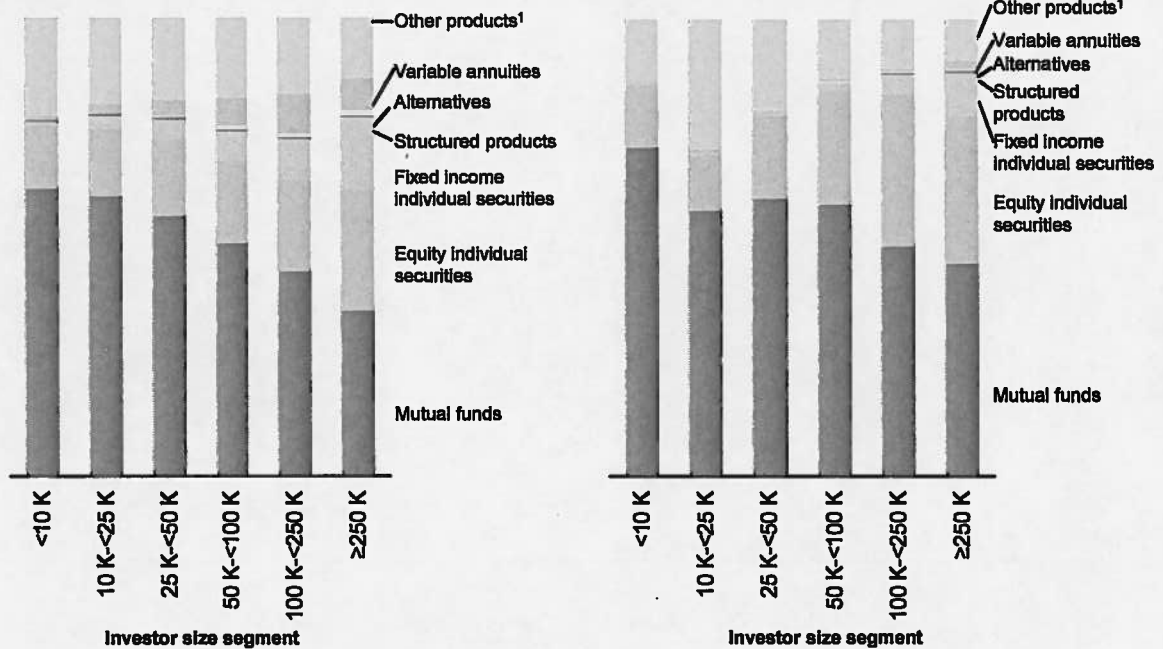
Investors will lose access to principal transactions which they may value to provide liquidity to obtain certain investments at favorable prices. In addition, a range of product choices currently offered predominantly in brokerage IRA relationships may no longer be able to be offered, such as some variable annuities, proprietary products to which clients may want specific access, unique structured products, as well as a wide array of third-party solutions available at those firms.

**Figure 14: Asset allocation comparison shows investors favor brokerage accounts for holding individual fixed income securities and variable annuities**

Allocation of assets (%) by IRA account size and model, year-end 2010

**Asset allocation in brokerage IRA accounts**  
Allocation of assets (%) by IRA account size, year-end 2010

**Asset allocation in advisory IRA accounts**  
Allocation of assets (%) by IRA account size, year-end 2010



Source: Oliver Wyman study sample  
1. Includes cash, money market funds, fixed and deferred annuities, etc.  
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**5.3. Increased cost**

Based on the study sample, a significant share of brokerage accounts may be able to continue receiving investment help and guidance by moving to an advisory relationship. Such investors would then face increased annual costs, due to the higher cost of servicing and maintaining these accounts. As shown in Figure 15, investors would pay an average of 73% to 196% more in direct costs in a fee-based advisory model.

**Figure 15: Fee-based advisory accounts are more expensive for investors of all account sizes**

Direct per account costs<sup>1</sup> for brokerage and fee-based accounts, 2010

	10K-<25K	25K-<50K	50K-<100K	100K-<250K	≥250K
<b>Brokerage</b>	\$80	\$135	\$230	\$455	\$1,070
<b>Advisory</b>	\$135	\$275	\$555	\$1,245	\$3,165
<b>% cost difference (advisory – brokerage)</b>	73%	106%	142%	173%	196%

Source: Oliver Wyman study sample

1. Excludes marketing and distribution, shareholder services, and other fees not directly paid by investors

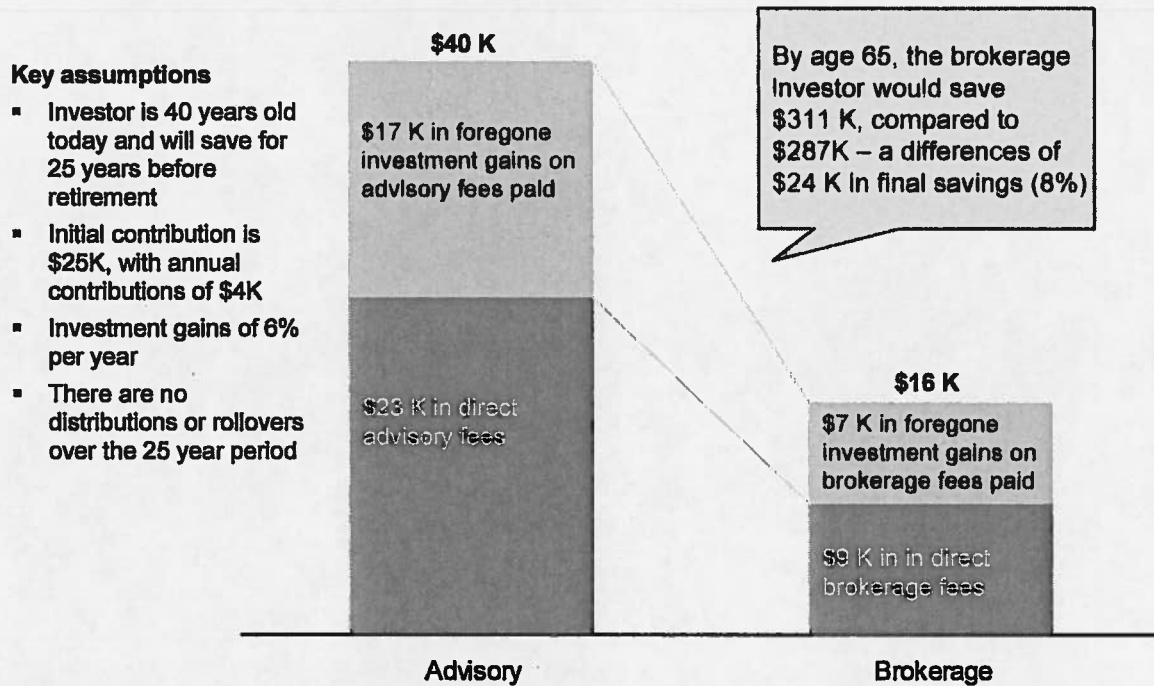
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In addition to direct costs paid by investors, firms may also receive marketing, distribution, shareholder services, and other fees in connection with providing brokerage IRA services not paid directly by investors. Firms vary in whether they receive such fees and how they account for them. If the Department of Labor's proposal were to be adopted as proposed, such fees would likely be restricted or eliminated for many IRAs. To the extent such fees are considered, the cost difference between the brokerage and advisory IRA models would narrow, though brokerage would continue to be less expensive across all account sizes in the study sample.

These increased investment costs would serve as a drag on long-term investment gains, and therefore on the ultimate retirement savings available to impacted account holders. Figure 16 illustrates this point for a hypothetical 40-year old individual with \$25,000 in an IRA and 25 years of saving before retiring at age 65.

**Figure 16: The impact on retirement savings of the higher-cost advisory model is compounded over time**

Comparison of difference in direct fees paid and foregone investment gains over 25 years for a hypothetical investor under brokerage and fee-based advisory models



Source: Oliver Wyman study sample, Oliver Wyman analysis

Note: Cost of advisory and brokerage accounts based on actual direct costs observed in study sample, of 0.60%-0.80% for advisory accounts and 0.20%-0.50% for brokerage accounts, varying by wealth segment

Costs exclude marketing and distribution, shareholder services, and other fees not directly paid by the investor – the cost differential between the two models is still significant if these fees are included

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In this illustrative example, the IRA investor would have an additional \$24,000 (8%) of retirement savings available at age 65 under the brokerage model, in comparison to the advisor model.

**6. Conclusions**

The Department of Labor’s proposed rule change is motivated by a laudable objective: to ensure a high standard of care for retirement plan participants and account holders with regard to the receipt of services and investment guidance, amid an increasingly complex financial marketplace. However, we find that the proposed Department of Labor “fiduciary” definition rule is likely to have serious negative and unintended effects on the very individuals the change is supposed to help.

Based on the unprecedented collection of data on IRA account holders assembled to support our analysis, we conclude that the proposed rule will disproportionately

**negatively affect small balance IRA investors – those individuals most in need of support in reaching their retirement goals. The proposed rule is likely to change an important avenue through which retail investors save for retirement, denying millions of current and future IRA investors access to professional investment help and investment services, limiting choice of how they receive and pay for investment services, and increasing overall costs for such support when available.**

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ACCESS TO CALL CENTERS AND BROKER  
DEALERS AND THEIR EFFECTS ON  
RETIREMENT SAVINGS

Prepared by  
Quantria Strategies, LLC

*Final*

*April 9, 2014*



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## EXECUTIVE SUMMARY

**RE-PROPOSED REGULATIONS THAT ARE ANTICIPATED FROM THE DEPARTMENT OF LABOR (DOL) ARE GENERALLY EXPECTED TO CREATE FIDUCIARY RESPONSIBILITY FOR FINANCIAL SERVICE PROVIDERS THAT WILL LIMIT THE ACCESS TO ASSISTANCE PROVIDED BY CALL CENTERS AND BROKER-DEALERS WHEN TERMINATING EMPLOYEES FACE PLAN DISTRIBUTION DECISIONS. LIMITING ACCESS TO THIS ASSISTANCE COULD INCREASE ANNUAL CASH OUTS OF RETIREMENT SAVINGS FOR EMPLOYEES TERMINATING EMPLOYMENT BY \$20 – 32 BILLION. THESE WITHDRAWALS COULD REDUCE THE ACCUMULATED RETIREMENT SAVINGS OF AFFECTED EMPLOYEES BY 20 TO 40 PERCENT.**

- If expected DOL re-proposed regulations apply the fiduciary standard to advice to retirement plan participants concerning their distribution options, millions of participants could lose access to call center and broker-dealer assistance upon job termination. Approximately 50 million job terminations occur each year among wage and salary workers in the United States.<sup>1</sup> Terminating employees often need to make decisions about their retirement savings, including what to do with retirement savings accumulated in the former employer's retirement savings plan. Our empirical model indicates that losing access to financial assistance at job termination could have significant impacts on long-term retirement savings; our results found that retirement savings balances are 33 percent higher for individuals who have access to financial assistance. While beyond the scope of this study, we note our results suggest that reduced access to financial assistance generally could have broad, long-term effects on plan participants that are not limited to plan participants who terminate employment.<sup>2</sup>
- According to a 2011 survey, 42 percent of terminating employees take a cash distribution from their retirement savings, 29 percent roll their retirement savings to another plan or an IRA, and 29 percent leave their assets in the employer's plan.<sup>3</sup> Terminating employees cashed out approximately 7.3 percent of their total retirement assets. Further, these distributions are more likely to occur among individuals who (1) have a low account balance, (2) are under age 30, or (3) have lower wages. Higher cash-out rates are also an issue for African-Americans and Hispanics.
- Employees are less likely to take cash withdrawals of their retirement savings if they discuss their distribution options with a call center or broker-dealer upon job termination. One company found that terminating employees with account balances between \$35,000 and \$50,000 are approximately 3.2 times less likely to cash out their retirement savings if they receive a call from a licensed representative of the company compared to similarly situated terminating employees who only receive written communications.
- DOL's re-proposed regulations may eliminate access to call centers and broker-dealer assistance with respect to distribution advice. A recent Government Accountability Office (GAO) report suggests that terminating employees often receive guidance and marketing that could favor IRA

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<sup>1</sup> Hathaway, Kendra C. *Job openings continue to grow in 2012, hires and separations less so*. Bureau of Labor Statistics, JOLTS Publications, JOLTS Annual Story, 2012.

<sup>2</sup> The data used in our model do not specifically examine the effect of financial assistance on cash-out behavior, but rather look at the overall effects of financial assistance on retirement savings.

<sup>3</sup> *Leakage of Participants' DC Assets: How Loans, Withdrawals, and Cashouts Are Eroding Retirement Income, 2011*. AON Hewitt, 2011. The study found these percentages were consistent with pre-economic downturn numbers.

rollovers.<sup>4</sup> However, very importantly, the GAO also noted the fears of fiduciary liability could inhibit communications with employees and the provision of information regarding distribution options. Inhibiting these communications creates a great risk to retirement savings – that terminating employees will take cash distributions instead of leaving their assets in their employer’s plan or rolling over the assets to another plan or IRA. From a retirement security perspective, retaining the assets in either an employer plan or IRA is preferable to cashing out.

Davis & Harman, LLP commissioned this report on behalf of a coalition of financial services organizations that provide retirement services to millions of Americans.

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<sup>4</sup> United States Government Accountability Office. *401(K) PLANS. Labor and IRS Could Improve the Rollover Process for Participants*. GAO-13-30, March 2013.

# I. FINDINGS AND OVERVIEW OF RESEARCH

## A. FINDINGS

- Employees need to make numerous decisions about their retirement savings, including whether and when to participate in an employer-sponsored retirement plan or IRA, how much to contribute, how to invest the assets in the plan or IRA, and when and how to take a distribution. A substantial body of research shows that Americans frequently lack the basic financial literacy needed to make decisions about their retirement savings. This lack of financial literacy causes employees to make suboptimal decisions concerning their retirement savings.
- One of the critical “choke points” in the retirement savings process occurs when an employee changes jobs or retires; at this point, an individual must decide what to do with retirement savings accumulated in a former employer’s plan. The job termination “choke point” will occur multiple times during an employee’s working career; on average, approximately 50 million job terminations occur each year among wage and salary workers in the United States.<sup>5</sup> In 2012, half of all wage and salary workers in the United States had been with an employer for less than 4.6 years.<sup>6</sup>
- Many people do not understand the long-term consequences of taking cash withdrawals of retirement savings at job termination. If a terminating employee decides to withdraw retirement savings and not roll the assets over to an IRA or another qualified plan, the employee loses not only the amount of the withdrawn assets, but also the future earnings on these amounts (i.e., the benefits of interest compounding). Furthermore, if an employee is younger than 59½ years old, she generally would also pay an additional 10 percent tax on the taxable portion of any withdrawal that is not rolled over.
- According to a 2011 survey, 42 percent of employees take a cash distribution from their retirement savings at job termination, 29 percent roll their retirement savings to another plan or an IRA, and 29 percent leave their assets in the employer’s plan.<sup>7</sup> The cash-out rate varies by account size; the survey found a 75 percent cash-out rate for participants with less than \$1,000 in their account and a 10 percent cash-out rate for participants with at least \$100,000 in their account. Terminating employees cashed out approximately 7.3 percent of their total retirement assets.
- Cash-outs are more likely to occur among individuals who (1) have a low account balance, (2) are under age 30, or (3) have lower wages. Higher cash-out rates are also an issue for African-Americans and Hispanics.
- A recent General Accountability Office (GAO) report suggested that employees who change jobs often receive guidance and marketing from service providers’ call centers encouraging them to roll their retirement savings into IRAs rather than keeping the

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<sup>5</sup> Hathaway, Kendra C. *Job openings continue to grow in 2012, hires and separations less so*. Bureau of Labor Statistics, JOLTS Publications, JOLTS Annual Story, 2012.

<sup>6</sup> Ibid.

<sup>7</sup> *Leakage of Participants’ DC Assets: How Loans, Withdrawals, and Cashouts Are Eroding Retirement Income, 2011*. AON Hewitt, 2011. The study found these percentages were consistent with pre-economic downturn numbers.

savings in a 401(k) plan.<sup>8</sup> However, this report ignores the fact that the greatest risk to retirement savings is that employees will take a cash distribution upon job termination. From a retirement security perspective, retaining the assets in either an employer plan or an IRA is preferable to cashing out.

- Employees who interact with a call center or broker-dealer to help them understand their options upon job termination are less likely to take cash withdrawals of their retirement savings. We contacted a number of financial services companies about the interactions between terminating employees and call centers. One company found that terminating employees with account balances between \$35,000 and \$50,000 are approximately 3.2 times less likely to cash out their retirement savings if they receive a call from a licensed representative of the company compared to similarly situated terminating employees who only receive written communications.
- These statistics are consistent with our analysis of a Department of Labor (DOL) pilot survey conducted as part of the Rand American Life Panel. Our empirical models suggest that access to financial assistance results in plan balances that are 33 percent higher than for individuals who do not have access to financial assistance.<sup>9</sup>
- DOL's re-proposed regulations may eliminate access to call centers and broker-dealer assistance with respect to distribution advice. If this happens, the cash-out rates of employees terminating employment will increase and retirement savings will decline in both the short- and long-term. We estimate that eliminating the availability of call centers and reducing broker-dealer assistance upon job termination will increase annual cash outs of retirement savings by an additional \$20 – 32 billion. Over the long run, these cash outs will result in a significant reduction in overall retirement savings; our estimates indicate that these withdrawals could reduce the ultimate retirement savings of affected individuals by 20 to 40 percent.

## ***B. OVERVIEW OF RESEARCH***

DOL is expected to issue re-proposed regulations addressing the issue of fiduciary liability with respect to retirement savings plans. These re-proposed regulations may limit the ability of financial services companies to assist individuals who are terminating employment with respect to their distribution options for their retirement savings assets. This limitation would arise because DOL's prohibited transaction rules would generally preclude any advice from a financial services company, even if the advice is in the best interest of the individual, unless the DOL provides comprehensive exemptions from such rules. Accordingly, we examined the potential effects on cash outs of retirement savings when employees terminate employment and the long-term implications for overall retirement savings if the re-proposed regulations apply the fiduciary standard to assistance with respect to distribution options without the prohibited transaction exemptions needed to permit the kind of assistance that is currently being provided to terminating employees by call centers and broker dealers.

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<sup>8</sup> United States Government Accountability Office. *401(k) Plans. Labor and IRS Could Improve the Rollover Process for Participants*. GAO-13-30, March 2013.

<sup>9</sup> The survey does not specifically examine the effect of financial assistance on cash-out behavior, but rather looks at the overall effects of financial assistance on retirement savings.

A substantial body of research in the United States finds that financial literacy presents a significant problem for retirement savings adequacy. Individuals tend to make suboptimal decisions concerning their retirement savings and the problem is particularly acute for individuals in particular demographic groups, including individuals with lower income, individuals with less education, the young, and the old (retired or near retired). Women, African-Americans, and Hispanics also face unique challenges in this area.

Research has also shown that consulting with a financial planner or advisor positively correlates with retirement savings balances, suggesting that access to a financial planner or advisor will improve retirement savings outcomes. However, most of the research focuses on individuals who hire a paid financial planner; these individuals are likely to have characteristics associated with positive savings behavior (e.g., such characteristics include higher income and higher educational attainment). Generally, individuals with these characteristics have a greater propensity to save notwithstanding the consultation with a financial planner or advisor.

However, none of the research to date has explored the outcomes associated with the assistance provided by call centers or broker dealers to a retirement plan participant at termination of employment. Generally, this assistance occurs when an individual contacts a call center or broker-dealer associated with the employer's retirement savings plan; these contacts may also occur through a proactive contact by a call center. For a terminating employee, these types of contacts assist the employee by providing the various options with respect to his or her retirement savings and often counsel the employee against cashing out the retirement savings.

This study examines the possible correlation between access to a call center or broker-dealer and the short- and long-term accumulation of retirement savings for employees who terminate employment. Our analysis expands on existing research by considering the effects on retirement savings if terminating employees should lose access to call centers or broker dealers.

The study relies on data from the Rand American Life Panel (ALP), which follows approximately 6,000 individuals who participate in occasional, on-line surveys. The approximately 350 surveys conducted to date provide data on financial decision-making, access to financial advice, financial literacy, income, retirement savings, demographics, and such other topics as self-reported health and wellbeing. This study uses a regression-based model of total retirement savings balances to attempt to isolate the effect of financial advice, controlling for other variables that may also be important in determining the size of total retirement savings.<sup>10</sup>

The study also utilizes confidential data provided by several large financial service companies concerning the volume and outcome of call center assistance provided to employees with respect to their retirement savings. This additional data helps to isolate the potential effects of call center assistance at employment termination and provides additional support for the results of the regression analysis.

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<sup>10</sup> See Appendix A for a technical discussion of the empirical analysis of the ALP survey results. Because the ALP does not specify the type of financial assistance provided, it does not allow a distinction between the use of a paid financial advisor for retirement savings assistance and consultation with a call center or broker dealer offered as a routine service to employees participating in an employer-sponsored retirement savings plan. Further, the ALP does not distinguish between general assistance and specific assistance provided when an employee terminates employment with an employer.

## II. RETIREMENT SAVINGS AND FINANCIAL LITERACY

### A. AMERICAN WORKERS LACK FINANCIAL LITERACY

*Employees need to make numerous decisions about their retirement savings, including whether and when to participate in an employer-sponsored retirement plan or IRA, how much to contribute, how to invest the assets in the plan or IRA, and when and how to take a distribution. A substantial body of research shows that Americans frequently lack the basic financial literacy needed to make decisions about their retirement savings. This lack of financial literacy causes employees to make suboptimal decisions concerning their retirement savings.*

A substantial body of research has explored the causes of suboptimal retirement savings in the United States. One of the problems commonly identified in the literature is that many U.S. workers lack financial literacy, which means that they lack basic understanding of key financial concepts, such as the benefits of interest compounding. Other research has focused on the effects of access to financial advice and financial education programs as a way to counter lack of financial literacy.

Across all age groups, individuals lack essential knowledge of basic financial concepts, including interest compounding, the effects of inflation, and diversification of risk.<sup>11</sup> In multiple surveys and studies, the research shows that a significant percentage of U.S. workers (1) cannot answer correctly the most simple multiple choice questions on issues of basic financial literacy, (2) fail to plan adequately for retirement, (3) consistently underestimate the amount of retirement savings they will need, and (4) make decisions, such as cashing out their retirement savings prior to retirement age, that adversely impact their long-term retirement savings.<sup>12</sup>

Amromin et al reviewed the literature on financial literacy and concluded that the surveys and studies varied significantly in content and sample population, but generally agreed on the following:

- “(1) a large proportion of consumers are not financially literate, even among the wealthiest and most educated population segments,
- (2) financial literacy rates vary consistently by demographic groups, tending to be high for those with more wealth and education, for men (although results vary), and for whites (in the U.S.), and
- (3) financial illiteracy leads to welfare-reducing financial behavior and outcomes.”<sup>13</sup>

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<sup>11</sup> See, for example, Lusardi, Annamaria and Olivia S. Mitchell. *Financial Literacy and Retirement Planning in the United States*, February 1, 2011. Lusardi, Annamaria and Olivia S. Mitchell. *Financial Literacy and Planning: Implications for Retirement Wellbeing*. University of Michigan Retirement Research Center, MRRC Working Paper n. 2006-144.

<sup>12</sup> The list of references at the end of this paper contains multiple sources for research relating to financial literacy and retirement saving.

<sup>13</sup> Amromin, Gene, Itzhak Ben-David, Sumit Agarwal, Souphala Chomsisenphet, and Douglas D. Evanoff. *Financial Literacy and the Effectiveness of Financial Education and Counseling: A Review of the Literature*. Accessed at: [http://www.chicagofed.org/digital\\_assets/others/region/foreclosure\\_resource\\_center/more\\_financial\\_literacy.pdf](http://www.chicagofed.org/digital_assets/others/region/foreclosure_resource_center/more_financial_literacy.pdf).



Low levels of financial literacy present particularly acute problems for certain demographic groups, such as individuals with low education. Concerns have also been raised about the challenges facing women, African-Americans, and Hispanics.<sup>14</sup>

These challenges translate to average account balances in 401(k) plans that are significantly lower for African-Americans and Hispanics than other demographic groups.<sup>15</sup> Table 1 shows average account balance, by salary range, for African-Americans, Hispanics, and whites participating in a 401(k) or 403(b) plan of 60 of the largest business and nonprofit organizations in the United States. Across all salary ranges, African-Americans and Hispanics have lower average account balances than their white counterparts.

Salary	African-American		Hispanic		White	
	2007	2010	2007	2010	2007	2010
\$0 – \$29,999	\$7,518	\$7,557	\$7,930	\$8,949	\$13,836	\$14,563
\$30,000 – \$59,999	\$28,169	\$24,505	\$28,727	\$27,823	\$44,546	\$42,720
\$60,000 – \$89,999	\$71,630	\$68,343	\$77,991	\$76,031	\$101,535	\$98,290
\$90,000 – \$119,999	\$122,208	\$132,222	\$125,520	\$138,274	\$164,897	\$182,061
\$120,000 and over	\$173,490	\$201,585	\$167,781	\$206,007	\$243,115	\$285,341

Source: *401(k) Plans in Living Color. A Study of 401(k) Savings Disparities Across Racial and Ethnic Groups*. The Ariel/Aon Hewitt Study 2012.

At the lowest salary levels, the average account balances of African-Americans and Hispanics are only approximately 60 percent of the average for whites. The percentage disparity becomes smaller as salaries increase, but even at the highest salary levels, the average account balances of African-Americans and Hispanics tend to be approximately 70 percent of the average for whites. While a variety of factors (e.g., lower participation and contribution rates) account for these disparities, preretirement cash-outs of retirement savings represents one significant factor (discussed in greater detail below) affecting account balances for all workers, but particularly for minority and ethnic groups.

**B. JOB TURNOVER CREATES RETIREMENT SAVINGS “CHOKE POINT”**

*One of the critical “choke points” in the retirement savings process occurs when an employee changes jobs or retires; at this point, an individual must decide what to do with retirement savings accumulated in a former employer’s plan. The job termination “choke point” will occur multiple times during an employee’s working career; on average, approximately 50 million job terminations occur each year among wage and salary workers in the United States. In 2012, half of all wage and salary workers in the United States had been with an employer for less than 4.6 years.*

From a retirement savings perspective, financial illiteracy causes workers to make bad decisions at important “choke points” in the retirement savings process. We define choke points as critical points in an individual’s working life when savings behavior may change. One of the critical

<sup>14</sup> *Ibid*, at p. 12.

<sup>15</sup> *401(k) Plans in Living Color. A Study of 401(k) Savings Disparities Across Racial and Ethnic Groups*. Ariel Education Initiative, Aon Hewitt, Joint Center on Political and Economic Studies, and The Raben Group, 2012.

“choke points” in the retirement savings process occurs when an employee changes jobs or retires; at this point, an individual must decide what to do with retirement savings accumulated in a former employer’s plan. At this time, an individual may dis-save (take a cash out of retirement savings) or temporarily or permanently stop saving for retirement. Thus, decisions made at the job termination choke point affect the ability of an individual to accumulate adequate savings for retirement security.

More than half of all employers offer their employees the ability to defer current wages and salary into a defined contribution retirement account (often a 401(k) plan).<sup>16</sup> These accounts typically offer an employer matching contribution in addition to the employee deferrals. In 2011, employees contributed approximately \$186 billion and employers provided matching contributions of an additional \$122 billion.<sup>17</sup>

One of the advantages of a defined contribution plan is that it provides portability for employees upon job change. An employee who terminates employment typically has several options with respect to his or her accumulated retirement savings; the individual can:

- leave the retirement savings in the old employer’s plan;
- transfer or roll over their retirement savings to a new employer’s plan or an IRA; or
- withdraw the accumulated retirement savings and use them for nonretirement purposes.

Plan portability can be important because of the mobility of the U.S. workforce. On average, approximately 4 million wage and salary workers in the United States separate from service with an employer each month for approximately 50 million job terminations per year.<sup>18</sup> Most workers will change jobs multiple times during their working careers. While it is difficult to estimate the number of job changes that individuals will have during their working career, one study (the National Longitudinal Survey of Youth 1979) tracked early Baby Boomers (ages 45-53 in 2010-2011) and found that, on average, this group had held 11.3 jobs from ages 18-46.<sup>19</sup>

The median job tenure for wage and salary workers in the United States was 4.6 years in 2012, meaning that half of all wage and salary workers had been with an employer for less than 4.6 years.<sup>20</sup> Job turnover rates are particularly high for some minority and ethnic groups with 51.5 percent of African-Americans, 56.2 percent of Hispanics, and 53.4 percent of Asians working for their current employer for less than five years.<sup>21</sup> Less than 30 percent (29.2) of the total wage and salary workforce has been employed with their current employer for 10 or more years.<sup>22</sup>

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<sup>16</sup> Refer to Copeland, Craig, Ph.D., *Retirement Plan Participation: Survey of Income and Program Participation (SIPP) Data, 2012*, Employee Benefits Research Institute. The study indicates that, based on the latest Survey of Income and Program Participation data from the U.S. Census Bureau, 61 percent of all workers over age 16 had an employer that sponsored a pension or retirement plan for any of its employees in 2012. The percentage of workers participating in a plan was 46 percent in 2012.

<sup>17</sup> U.S. Department of Labor, Employee Benefit Security Administration, *Private Pension Plan Bulletin, Abstract of 2011 Form 5500 Annual Reports*, June 2013..

<sup>18</sup> Hathaway, Kendra C. *Job openings continue to grow in 2012, hires and separations less so*. Bureau of Labor Statistics, JOLTS Publications, JOLTS Annual Story, 2012.

<sup>19</sup> U.S. Department of Labor, Bureau of Labor Statistics. *Number of Jobs Held, Market Activity, and Earnings Growth Among the Youngest Baby Boomers: Results From a Longitudinal Survey*. USDL-12-1489, July 25, 2012

<sup>20</sup> *Employee Tenure in 2012*. Bureau of Labor Statistics, Economic News Release, September 18, 2012.

<sup>21</sup> *Ibid.*

<sup>22</sup> *Ibid.*

The statistics suggest that job turnover represents a pivotal point in the retirement savings process when employees must make decisions about what to do with the retirement savings they have accumulated with their employer. This “choke point” occurs multiple times during an average working career. Withdrawals from retirement savings that occur upon job change represent not only the loss of the amount of accumulated savings, but also the loss of the benefits of compounding that occurs when these amounts are withdrawn from retirement savings.

### ***C. CASHOUTS OF RETIREMENT SAVINGS ERODE LONG-TERM RETIREMENT SECURITY***

*If a terminating employee decides to withdraw retirement savings and not roll the assets over to an IRA or another qualified plan, the employee loses not only the amount of the withdrawn assets, but also the future earnings on these amounts (i.e., the benefits of interest compounding).*

U.S. retirement assets totaled \$20.9 trillion as of June 30, 2013.<sup>23</sup> Estimates indicate that preretirement withdrawals from retirement savings total from \$70 to \$104 billion each year.<sup>24</sup> While these withdrawals represent a small percentage of total retirement assets (0.34 to 0.50 percent), even modest withdrawals from individual accounts can reduce the ability of individuals to attain adequate retirement savings. Further, increases in the cash-out rate could result in significant declines in retirement security in the United States.

Preretirement withdrawals (commonly referred to as leakage) from retirement savings can occur in a number of ways. Loans, in-service withdrawals (for hardships and life events), and distributions that occur at (or following) job change are three forms of leakage that diminish retirement savings balances.

This analysis focuses on withdrawals at job termination, which affect retirement savings in two ways. First, if the individual does not replace or rollover the retirement savings to another employer plan or an IRA, the withdrawals will reduce the individual's overall account balance. Second, even if the individual replaces the funds at a subsequent time, the individual loses the benefits of the tax-deferred earnings on the amounts withdrawn and the compounding effects of interest accumulation.

A recent study found that, for tax year 2010, distributions from qualified retirement plans totaled \$1,281 billion, \$241 billion of which went to taxpayers under age 55.<sup>25</sup> Nearly half of this amount, \$104.3 billion, was subject to tax and, in some cases, subject to early withdrawal penalties (see Graph 1). Recognizing the inclination of many individuals not to leave portable retirement funds with a former employer, more than \$100 billion was rolled over (directly or indirectly) to other qualified accounts.

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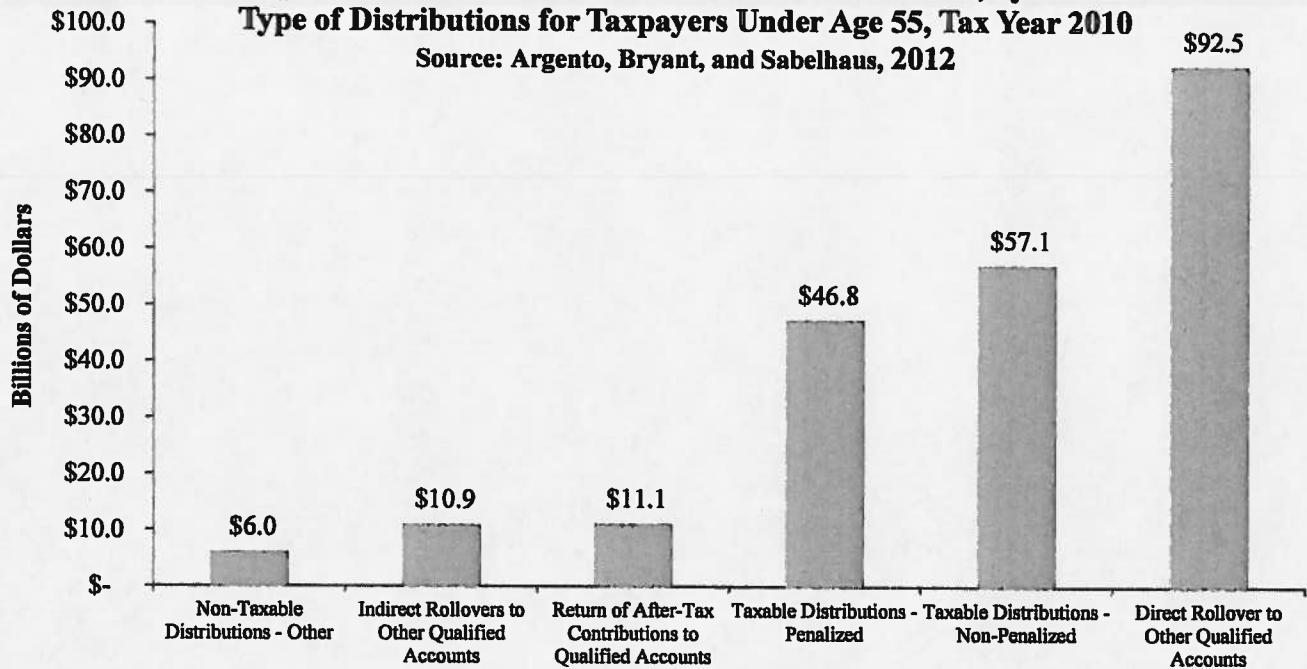
<sup>23</sup> Investment Company Institute, Research and Statistics. *Retirement Assets Total \$20.9 Trillion in Second Quarter 2013, September 30, 2013*. Accessed at: [http://www.ici.org/research/retirement/retirement/ret\\_13\\_q2](http://www.ici.org/research/retirement/retirement/ret_13_q2).

<sup>24</sup> Refer to Fellowes, Matt and Katy Willemin, *The Retirement Breach in Defined Contribution Plans Size, Causes, and Solutions*, HelloWallet, January 2013 and Argento, Robert and Victoria L. Bryant, John Sabelhaus, *Early Withdrawals from Retirement Accounts During the Great Recession*, prepared for presentation at the November, 2012, National Tax Association annual meetings, November 2012.

<sup>25</sup> Refer to Argento, Robert and Victoria L. Bryant, John Sabelhaus, *Early Withdrawals from Retirement Accounts During the Great Recession*, prepared for presentation at the November, 2012, National Tax Association annual meetings, November 2012.

**Graph 1 Total Distributions from Retirement Accounts, by Selected Type of Distributions for Taxpayers Under Age 55, Tax Year 2010**

Source: Argento, Bryant, and Sabelhaus, 2012

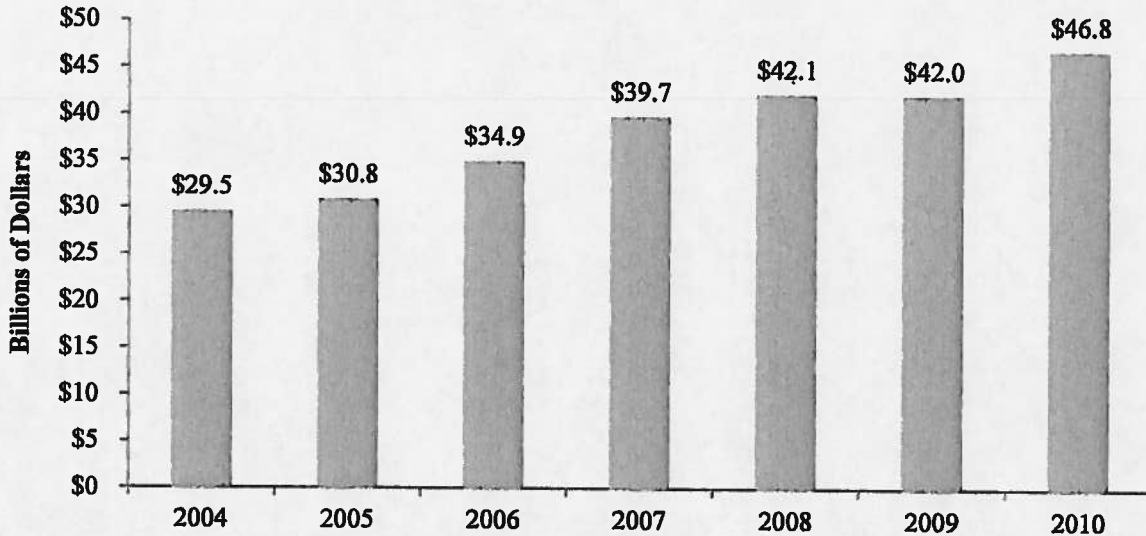


The study estimated that nearly 25 percent of all taxpayers *younger than age 55 with current pension coverage* (or retirement balances from past contributions) had a gross distribution in 2010. Among those taxpayers with a gross distribution, approximately 67 percent of the taxpayers had a taxable distribution, and about 40 percent had a penalized distribution. With respect to the dollar amounts, approximately 43 percent of the gross distribution amounts were subject to tax and nearly 20 percent of the gross distributions (approximately \$46.8 billion) were subject to early withdrawal penalties. (Refer to Graph 1.)<sup>26</sup> Graph 2 shows the annual penalized distributions for taxpayers under age 55, for 2004 to 2010.

<sup>26</sup> Note there are modest discrepancies in the data reported in the 2010 Argento et al paper. For instance, the penalized amount for 2010 is listed in Table 1 as \$47.3 billion, but in Table 3, this amount is listed as \$46.8 billion. However, the discrepancy is small enough to be irrelevant for the purposes of this study. For purposes of our study, we report the \$46.8 billion figure.

**Graph 2 Total Distributions from Retirement Accounts Subject to a Tax Penalty, for Taxpayers Under Age 55**

Source: Argento, Bryant, and Sabelhaus, 2012



When workers make a job change (either voluntarily or involuntarily terminate employment), they have several options available with respect to their retirement assets – generally, they may keep the assets in the original employer’s plan, roll over the assets to an IRA or to a retirement savings plan of a new employer, or cash out the balance.

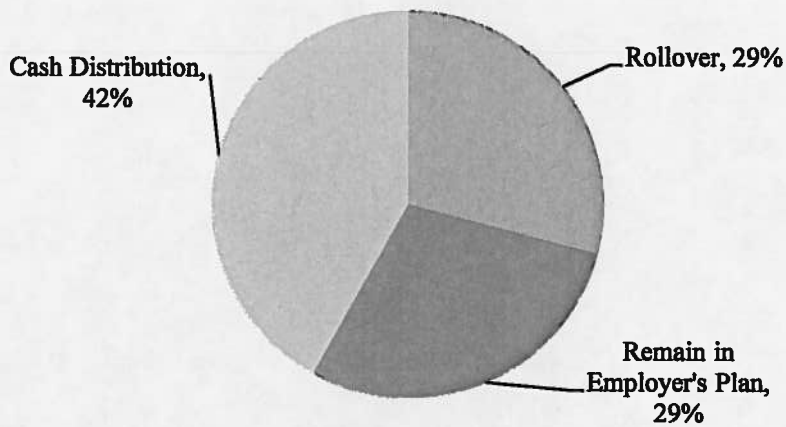
*According to a 2011 survey, 42 percent of employees take a cash distribution of their retirement savings at job termination, 29 percent roll their retirement savings to another plan or an IRA, and 29 percent leave their assets in the employer’s plan.<sup>27</sup> The cash-out rate varies by account size; the survey found a 75 percent cash-out rate for participants with less than \$1,000 in their accounts and a 10 percent cash-out rate for participants with at least \$100,000 in their accounts. Total assets cashed out represented 7.3 percent of total retirement savings assets of terminating employees.*

Thus, empirical research indicates that nearly half of all workers take cash distributions when terminating employment.<sup>28</sup> On a plan-asset weighted basis, cash distributions in the 2011 survey represented 7.3 percent of the total amounts available at employment termination, with 54.7 percent of assets remaining in the employer’s plan and 38 percent of assets rolled over to another employer retirement plan or an IRA (refer to Graph 3).

<sup>27</sup> *Leakage of Participants’ DC Assets: How Loans, Withdrawals, and Cashouts Are Eroding Retirement Income 2011.* Aon Hewitt, 2011.

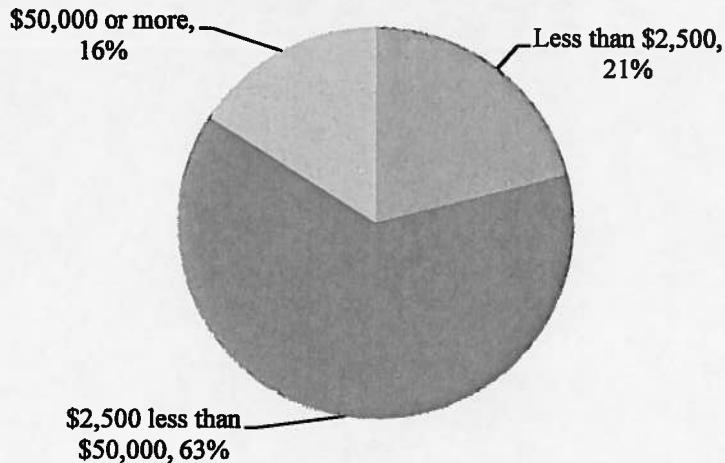
<sup>28</sup> One survey indicated that this percentage could be as high as 68 percent, although the data may be out of date. Refer to Moore, James H. and Leslie A. Muller, *An analysis of lump-sum pension distribution recipients*, Monthly Labor Review, May 2002.

**Graph 3 Treatment of Retirement Plan Assets, after Employment Terminations, Percentage of Employees**  
Source: Aon Hewitt Survey, 2011



Cashing out tends to be the most prevalent behavior with average distributions of \$32,219 (in 2006 dollars).<sup>29</sup> The following graph (Graph 4) displays the range of distribution amounts for individuals taking a lump-sum distribution when changing jobs.

**Graph 4 Lump-Sum Distributions at Job Change, by the Size of the Distribution**  
Source: EBRI Notes, January 2009



<sup>29</sup> EBRI Notes, Lump-Sum Distributions at Job Change, Vol. 30, No. 1, January 2009.

## D. CASH-OUTS MORE LIKELY AMONG CERTAIN GROUPS

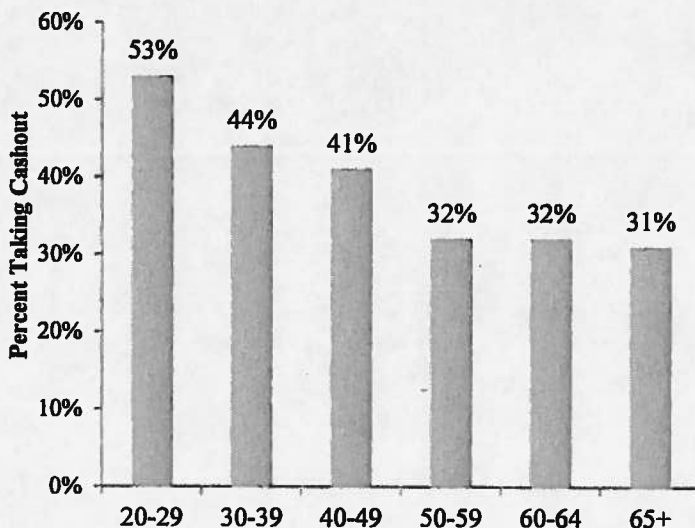
*Cash-outs are more likely to occur among individuals who (1) have a low account balance, (2) are under age 30, or (3) have lower wages. Higher cash-out rates are also an issue for African-Americans and Hispanics.*

Certain participant characteristics provide an indicator of the likelihood that employees will cash out their retirement savings at job change. These characteristics relate to the amount of retirement savings accumulated, as well as certain demographic characteristics, including the employee's age, income, and race or ethnicity.

**1. Account Balances** – The likelihood that an employee will cash out a retirement account after terminating employment correlates negatively with the employee's account balance. As an employee's account balance increases, a terminating employee is less likely to cash out the account. As noted above, one study estimated that the average cash distribution at job change was \$32,219 in 2006.<sup>30</sup>

**2. Age of the Workers** – Younger workers tend to have lower account balances relative to their older cohorts (due to fewer years participating in a qualified plan). In addition, younger workers are much more likely to cash out these smaller account balances. The 2011 Aon Hewitt retirement survey estimated that 53 percent of terminating employees who were younger than 30 years of age cashed out their retirement savings.

**Graph 5 Percentage of Terminating Employees Who Cash Out Retirement Savings, by age, 2010**  
Source: Aon Hewitt Retirement Survey, 2011



Yet, research indicates that as an individual reaches 40 years of age or older, they tend to have financial challenges that make it more likely that they will use their retirement savings.<sup>31</sup> This is particularly true when an older worker terminates employment. In many cases, they have more complicated financial demands (e.g., retaining a primary residence or college-aged children) and retirement savings may represent the only available form of savings. Numerous surveys of plan participants report similar findings.<sup>32</sup> However, as participants age, they are more likely to retain their retirement assets, even following a job change.

**3. Lower-Paid Workers** – Workers with lower-wage employment also tend to be more likely to withdraw or cash-out retirement savings, particularly at job change. Research by

<sup>30</sup> Refer to Copeland, Craig, *Lump Sum Distributions at Job Change*, Employee Benefits Research Institute, Notes 30(1), January 2009.

<sup>31</sup> Refer to Fellowes, Matt and Katy Willemin, *The Retirement Breach in Defined Contribution Plans Size, Causes, and Solutions*, HelloWallet, January 2013.

<sup>32</sup> *Ibid.* Refer also to *Leakage of Participants' DC Assets: How Loans, Withdrawals, and Cashouts Are Eroding Retirement Income 2011*, AON Hewitt, 2011; and *How America Saves 2012*, The Vanguard Group, Inc., 2012.

Butrica, et al. indicates that workers in the lowest income quartile are much more likely (28.6 percent) to make withdrawals from retirement savings than those in the highest income quartile (16.4 percent).<sup>33</sup>

**4. Minority Workers** – African-American and Hispanic workers have significantly higher cash-out rates than white workers (see Table 2).

<b>Action</b>	<b>African-American</b>	<b>Hispanic</b>	<b>White</b>
Leave Balances in Employer Plan	12%	15%	27%
Rollover to New Plan or IRA	25	28	34
Cash-Out With Penalty	63	57	39

Source: *401(k) Plans In Living Color. A Study of 401(k) Savings Disparities Across Racial and Ethnic Groups*, the Ariel/Aon Hewitt Study 2012.

These higher cash-out rates could occur partially because the average account balances for African-Americans and Hispanics are significantly smaller than the average account balances for whites with the same salary rate. However, even accounting for size of account balances, African-American and Hispanic workers tend to have higher cash-out rates.

***E. DOL REGULATIONS MAY REDUCE ACCESS TO CALL CENTER AND BROKER-DEALER ASSISTANCE FOR TERMINATING EMPLOYEES***

On October 22, 2010, DOL proposed regulations to modify the standards for fiduciary liability with respect to retirement savings plans. In 2011, the DOL announced that the regulations would be re-proposed.<sup>34</sup> The re-proposed regulation is generally expected to apply the revised fiduciary standard to assistance provided to terminating employees by call centers and broker dealers. In some cases, a terminating employee will contact a call center or broker-dealer associated with an employer's retirement savings plan to understand his or her options with respect to the employee's retirement savings account balance. In other cases, a call center or broker-dealer might reach out directly to a terminating employee to help the employee understand his or her options. If broker-dealers and call centers become fiduciaries under the DOL regulations as expected, such contacts with terminating employees would generally be prohibited under the prohibited transaction rules, even if the advice given is in the best interest of the employees, unless comprehensive exemptions are provided by the DOL. If the re-proposed regulations fail to provide such exemptions for this type of assistance, then employees will lose access to call center and broker-dealer assistance at this critical choke point in the retirement savings process.

<sup>33</sup> Refer to Butrica, Barbara A., Sheila R. Zedlewski, and Philip Issa. *Understanding Early Withdrawals from Retirement Accounts*. The Urban Institute, The Retirement Policy Program, Discussion Paper 10-02, May 2010.

<sup>34</sup> United States Department of Labor News Release, Release Number: 11-1382-NAT, September 19, 2011.



## **F. ACCESS TO CALL CENTER AND BROKER-DEALER ASSISTANCE REDUCES CASH-OUTS**

*A recent GAO report suggested that employees who change jobs often receive guidance and marketing from service providers' call centers encouraging them to roll their retirement savings into IRAs rather than keeping the savings in a 401(k) plan. However, very importantly, the GAO also noted that fears of fiduciary liability could inhibit communications with employees and the provision of information regarding distribution options. Inhibiting these communications creates a great risk to retirement savings – that terminating employees will take cash distributions instead of leaving their assets in their employer's plan or rolling over the assets to another plan or IRA. However, the GAO report ignores the fact that the greatest risk to retirement savings is that employees will take a cash distribution upon job termination. From a retirement security perspective, retaining the assets in either an employer plan or an IRA is preferable to cashing out.*

The research on access to financial assistance typically examines assistance in the form of a paid financial advisor. However, individuals who seek assistance from a paid financial advisor tend to be those individuals who are higher income and have higher levels of financial literacy. Individuals with lower education and income, African-Americans, and Hispanics are significantly less likely to seek assistance from a paid financial advisor.

In a 2008 paper, Lusardi stated “individuals are most prone to decision-making in specific time periods. For example, the start of a new job pushes people to think about saving (often because they have to make decisions about their pensions), and it may be very important to exploit such *teachable moments*.”<sup>35</sup> Lusardi goes on to state that “to be effective, programs have to recognize the many differences among individuals, not only in terms of preferences and economic circumstances but also of their existing levels of information, financial sophistication, and ability to carry through with plans. In other words, relying on ‘one-size-fits-all’ principles can lead to rather ineffective programs.”<sup>36</sup>

One of the key decision-making points for retirement savings is job termination, when an employee must decide what to do with their retirement savings with the employer. Employees frequently have access to a call center or a broker-dealer to help them understand their options at this decision-making point. In fact, most financial services firms make such assistance available to help employees make decisions concerning their retirement savings.

A recent study by the Government Accountability Office (“GAO”) indicated GAO’s strong preference for workers keeping their retirement savings in an employer plan, rather than moving the funds to an IRA.<sup>37</sup> However, this view does not address how to deal with many employees’ inclination not to leave their assets at their former employer’s plan, nor with some workers’ desires to obtain access to investments that may not be available under a former employer’s plan. Further, the GAO indicated that it had made calls to 401(k) and IRA service providers to request information about rollover options and IRAs, but it is unclear whether these calls went to sales lines or the company’s technical call centers. This clearly makes a significant difference in terms of the nature of the assistance. Most importantly, GAO’s report ignores the biggest risk to long-

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<sup>35</sup> Lusardi, Annamaria. *Financial Literacy: An Essential Tool for Informed Consumer Choice?* January 2008.

<sup>36</sup> *Ibid.*

<sup>37</sup> Refer to the Government Accountability Office, *401(K) PLANS Labor and IRS Could Improve the Rollover Process for Participants*, GAO-13-30, March 2013.

term retirement security, which is the preretirement cash out of retirement savings. From a retirement security perspective, retaining the assets in either an employer plan or an IRA is preferable to cashing out.

None of the research to date has examined the effects of employee access to call center assistance on retirement savings. As a result, very little information is available concerning the effects of call center assistance on retirement savings outcomes. In order to help fill this gap in the research, we conducted interviews of several large financial services firms serving a broad range of individuals concerning their call center operations with respect to employer retirement savings plans. The information and data collected from these interviews help to construct a better picture of how access to call centers assists employees with important retirement savings decisions.

Millions of employees contact call centers associated with their retirement plan each year.<sup>38</sup> Some of the calls represent basic transactions, such as a balance inquiry or providing an address change. For some companies, the initial call will be handled by a basic service representative, who will handle the most basic inquiries and will transfer the caller to a licensed representative for any other question or request.

The financial services firms view their call center operations as an important way to help educate employees on the importance of preserving their retirement savings. In addition to responding to employees who contact a call center, some companies make proactive calls to employees at key decision points to make sure employees are educated concerning their options. Companies with whom we spoke as part of our research generally indicated that their general approach was to discourage terminating employees from cashing out their retirement savings. One company indicated that, with terminating employees, they would send a letter explaining the employee's options, followed by a telephone call, generally advising against cashing out. Another company indicated that the most impactful way to help plan participants was a proactive call to help with options when an employee terminates employment.

In addition, some employees have direct access to a broker-dealer for assistance. This might occur if an employee has set up an IRA using a broker-dealer or if an employer (often a small employer) has a broker-dealer who helped the employer establish a retirement plan for employees. In many cases, broker-dealers assist employees who could not otherwise afford to hire a financial advisor. While it is more difficult to quantify the extent to which employees might access a broker-dealer for assistance for help understanding their options with respect to their retirement savings, this access represents another important way in which employees receive assistance with respect to their retirement savings and, more generally, their financial literacy.

As a result, call center and broker-dealer assistance is an important source of information to employees. The evidence suggests that access to this assistance improves retirement savings outcomes. One financial services company reported that cash-out rates for individuals with account balances between \$35,000 and \$50,000 decline significantly when an employee receives a proactive call (3.3 percent cash-out rate) relative to those who only receive a written communication (10.5 percent cash-out rate). This compares to a cash-out rate for this company of 34 percent for all former employees each year.

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<sup>38</sup> These call centers should be distinguished from the sales forces that may have been involved in the GAO study discussed above.

### **III. ESTIMATING THE EFFECTS OF REDUCING AVAILABILITY OF CALL CENTER OR BROKER-DEALER ASSISTANCE ON CASH-OUTS OF RETIREMENT SAVINGS**

When an employee terminates employment, cashing out accumulated retirement savings may be appealing. Many employees lack the basic financial literacy needed to make an informed decision, which leads to a failure to understand the long-term consequences of these cash-outs. In particular, an employee with high debt levels or other financial pressures rarely appreciates the importance of keeping the assets in a qualified retirement savings vehicle. Similarly, an employee who has a relatively small retirement savings balance does not understand the long-term consequences of cashing out. Finally, the process of rolling over retirement savings into a plan of a new employer or an IRA presents complexities that many plan participants fail to understand. Having access to a call center or broker-dealer for assistance may help a terminating employee gain a clearer picture of all the options with respect to his or her retirement savings and the consequences of each option.

If the DOL re-proposed regulations extend fiduciary liability to call center and broker-dealer assistance without an exemption to permit the types of contacts that routinely occur when employees terminate employment, then cash outs at termination of employment will increase and long-term retirement security will decline. The following sections estimate the potential impacts of these changes, including estimates of (1) the aggregate potential reduction in retirement savings and (2) the effect of cashing out retirement savings on retirement savings accumulations over a 30-year work history. These potential impacts may affect disproportionately individuals in the most vulnerable populations.

#### ***A. INCREASED WITHDRAWALS FROM RETIREMENT SAVINGS***

The estimates of increased cash-outs of retirement savings and reduced rollovers to IRAs and other qualified plans rely on a number of data sources as well as our estimates of the effect of call centers and/or broker-dealer assistance on these cash outs.

The first step in estimating the potential increases in cash-outs from retirement assets and reduced rollovers to IRAs and other qualified plans requires estimating pension participation by income class. This analysis relies on Internal Revenue Service (IRS) Statistics of Income (SOI) tabulations of the elective deferrals claimed on taxpayers' Form W-2 for 2010.<sup>39</sup> Table 3 displays the number of taxpayers with elective deferrals and the aggregate amount of the deferral.

The second step is to impute aggregate balances for the distribution of taxpayers reporting retirement contributions on Form W-2. This information relies on several surveys. Using multiple data sources provided an opportunity to verify and corroborate the assumptions applied to the taxpayer characteristics.<sup>40</sup>

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<sup>39</sup> The IRS tabulation of W-2 data includes elective deferrals from all employer-provided defined contribution amounts for primary and/or secondary taxpayers. Elective retirement contributions are reported on the Form W-2, box 12 and includes the following codes: code D (traditional 401k), code E (traditional 403b), code F (SEP), code G (457b), code H (501(c)(18)(D)), code S (SIMPLE), code AA (Roth 401k), and code BB (Roth 403b).

<sup>40</sup> Refer to Appendix A for a detailed description of the data sources and the methodology.

**Table 3 – Taxpayers with Elective Retirement Contributions, by  
Size of Adjusted Gross Income, 2010**  
*(Dollar Amounts are in thousands)*

<b>Adjusted Gross Income</b>	<b>Returns</b>	<b>Contribution Amount</b>
Under \$10,000	628,363	\$723,644
\$10,000 under \$20,000	1,840,733	1,205,130
\$20,000 under \$30,000	3,569,640	3,990,174
\$30,000 under \$40,000	4,116,205	6,896,514
\$40,000 under \$50,000	3,881,058	8,825,907
\$50,000 under \$75,000	8,927,933	28,557,724
\$75,000 under \$100,000	7,719,584	33,078,699
\$100,000 under \$200,000	11,607,079	79,943,732
\$200,000 or more	3,495,241	45,992,983
<b>Total</b>	<b>45,785,836</b>	<b>209,214,507</b>

Source: IRS, Statistics of Income tabulations of the elective deferrals claimed on taxpayers' 2010 Form W-2.

The third step is to estimate the qualified plan participants who may experience a break in service (through job termination) and face a decision regarding plan assets held with their previous employer. The Job Opening and Labor Turnover Survey (JOLTS) from the Bureau of Labor Statistics estimated that 37.1 percent of current workers experience separation from employment during the year. The definition of separation includes voluntarily quitting, being laid off, or being fired.<sup>41</sup>

From this information, we derive estimates of the potential retirement savings balances that are likely to become vulnerable to cash out.<sup>42</sup> We assume that those employees cashing out balances currently will continue to do so. With respect to employees choosing to leave account balances in a former employer's plan passively (through inaction), we assume that the small number of account balances that would have remained passively with the former employer will also be likely to remain there.

Our analysis assumes that the balances most vulnerable to increased cash-out are those currently being rolled into IRAs or a new employer plan and those that currently remain in an employer's plan through an employee decision. These amounts reflect those decisions that are most likely to be assisted by a call center or broker-dealer. Our estimates indicate that, each year, these balances total approximately \$117 to \$145 billion.

Our final step involves investigating the role of call center and broker-dealer assistance in helping workers retain their retirement savings at job change. Our research relies on a DOL-sponsored pilot survey that looks at how current enrollees in employer-sponsored defined contribution (DC) plans make retirement decisions.<sup>43</sup> Our empirical models suggest that

<sup>41</sup> Refer to Hathaway, Kendra C., *Job openings continue to grow in 2012, hires and separations less somewhat*, JOLTS Annual Story, Monthly Labor Review, May 2013.

<sup>42</sup> In addition, the estimates include an adjustment for the likelihood that workers separating from employment have access to a qualified plan.

<sup>43</sup> The survey asked the following question: "How do you make decisions about savings and investment related to retirement?" The possible responses were: "1 Ask relatives/friends, 2 Talk to financial planners/brokers, 3 Talk to lawyers, 4 Read magazines/newspapers/books, 5 Get advice from television, and 6 Other." Of the respondents who had not already retired, approximately 24 percent indicated that they had talked to financial planners/brokers. These contacts likely include both consultation with a paid financial planner and contacts through a call center or broker-dealer associated with their employer's retirement savings plan.

retirement savings plan balances are 33 percent higher if a financial planner or broker was consulted for financial advice. Our parameter estimates support our theory that consultations with call centers or brokers/dealers result in retirement savings in DC plans that are higher by about 33 percent. Our model suggests important life-cycle effects are present in retirement savings with plan balances increasing with age initially and then increasing at a decreasing rate as workers approach retirement age.

Based on the estimated cash-outs from retirement balances for terminating employees, we estimate that reducing the availability of call center and broker-dealer assistance will increase annual cash outs of retirement savings at job termination by an additional \$20 – 32 billion.<sup>44</sup>

### ***B. LONG-RUN EFFECTS ON RETIREMENT SECURITY***

Cash outs of retirement savings prior to retirement not only reduce retirement savings by the amount withdrawn, but also by the earnings that those amounts would accrue if they were not withdrawn.<sup>45</sup>

The following example shows the effects of withdrawals of retirement savings early in a working career, which corresponds to the work history of many workers who may change jobs three or four times during the early years of their working career. The first stream of retirement savings represents the accumulation of assets assuming no cash out prior to retirement age (i.e., the assets either remain in an employer's plan or the individual rolls over to an IRA or a new employer's plan). This individual, who earns \$40,000 in 2014 (assuming 2.5 percent annual increases in salary and a 5 percent deferral rate), will accumulate \$124,742 during her career (assuming 4 percent annual earnings on those contributions).<sup>46</sup>

Assume the same individual changes jobs three or four times during the early years of employment and cashes out her retirement savings at each job change with the final cash-out occurring after year six. This behavior means the individual is essentially beginning to save for retirement in the seventh year of employment. Withdrawing the retirement balances in the early years of employment (with consistent savings thereafter) will reduce the individual's accumulated retirement savings by \$32,093.

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<sup>44</sup> Refer to Appendix A for a detailed description of our empirical work.

<sup>45</sup> In addition, the amounts withdrawn frequently are subject to Federal and state income taxes plus penalty taxes on early withdrawals.

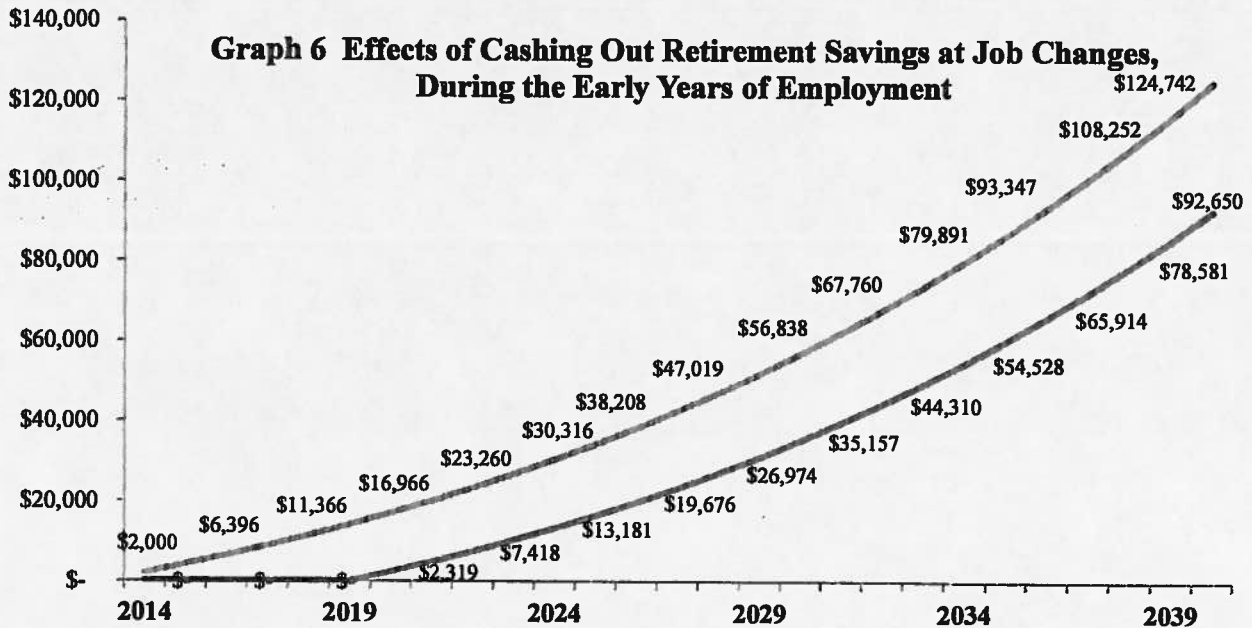
<sup>46</sup> This deferral rate is consistent with average deferrals based on Internal Revenue Service Statistics of Income data tabulations of the Form W-2 for taxpayers with \$40,000 of wage income.

**Table 4 – Effects of Cashing Out Retirement Savings, with Job Changes Early in the Work History**

Year	Account Balance		Year	Account Balance	
	No Distributions	Distribution at Job Changes		No Distribution	Distribution at Job Change
2014	\$ 2,000	\$ -	2028	\$ 47,019	\$ 26,974
2015	\$ 4,130	\$ -	2029	\$ 51,797	\$ 30,950
2016	\$ 6,396	\$ -	2030	\$ 56,838	\$ 35,157
2017	\$ 8,806	\$ -	2031	\$ 62,154	\$ 39,606
2018	\$ 11,366	\$ -	2032	\$ 67,760	\$ 44,310
2019	\$ 14,083	\$ -	2033	\$ 73,668	\$ 49,280
2020	\$ 16,966	\$ 2,319	2034	\$ 79,891	\$ 54,528
2021	\$ 20,022	\$ 4,790	2035	\$ 86,446	\$ 60,068
2022	\$ 23,260	\$ 7,418	2036	\$ 93,347	\$ 65,914
2023	\$ 26,688	\$ 10,212	2037	\$ 100,610	\$ 72,080
2024	\$ 30,316	\$ 13,181	2038	\$ 108,252	\$ 78,581
2025	\$ 34,152	\$ 16,332	2039	\$ 116,290	\$ 85,432
2026	\$ 38,208	\$ 19,676	2040	\$ 124,742	\$ 92,650
2027	\$ 42,494	\$ 23,220			

Both examples assume the individual has a starting salary of \$40,000, receives 2.5 percent annual increases, defers 5 percent of salary each year, and earns 4 percent interest on those contributions.

Graph 6 displays the effect of this behavior on the accumulated earnings. This reduces the ultimate retirement savings balance by approximately 26 percent.



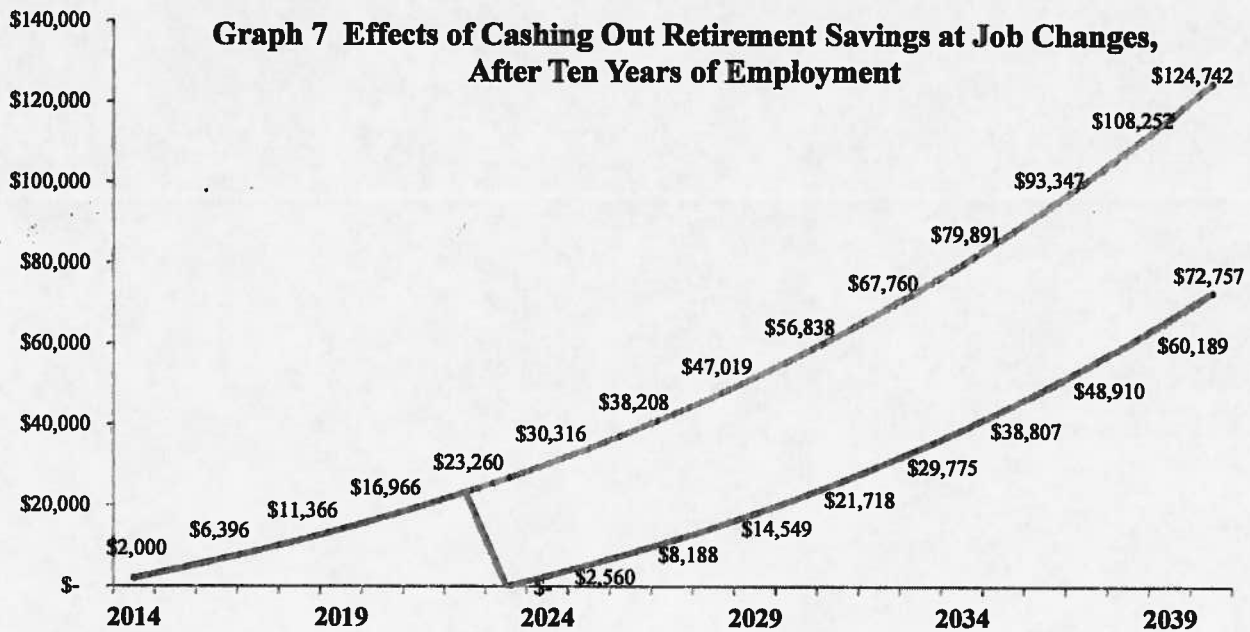
While it is common for younger workers to cash out balances, the average account distribution is considerably higher (\$32,219) suggesting that cash outs also occur later in a working career. Using the same example, this is comparable to a worker cashing out his or her retirement savings when changing jobs after 10 years. The effect of this behavior is to reduce the individual's total retirement savings by nearly \$52,000 or 41 percent.

**Table 5 – Effects of Cashing Out Retirement Savings, with  
Job Changes After 10 Years**

Year	Account Balance		Year	Account Balance	
	No Distributions	Distributions at Job Changes		No Distribution	Distribution at Job Change
2014	\$ 2,000	\$ -	2028	\$ 47,019	\$ 14,549
2015	\$ 4,130	\$ -	2029	\$ 51,797	\$ 18,028
2016	\$ 6,396	\$ -	2030	\$ 56,838	\$ 21,718
2017	\$ 8,806	\$ -	2031	\$ 62,154	\$ 25,630
2018	\$ 11,366	\$ -	2032	\$ 67,760	\$ 29,775
2019	\$ 14,083	\$ -	2033	\$ 73,668	\$ 34,163
2020	\$ 16,966	\$ -	2034	\$ 79,891	\$ 38,807
2021	\$ 20,022	\$ -	2035	\$ 86,446	\$ 43,718
2022	\$ 23,260	\$ -	2036	\$ 93,347	\$ 48,910
2023	\$ 26,688	\$ -	2037	\$ 100,610	\$ 54,396
2024	\$ 30,316	\$ 2,560	2038	\$ 108,252	\$ 60,189
2025	\$ 34,152	\$ 5,287	2039	\$ 116,290	\$ 66,304
2026	\$ 38,208	\$ 8,188	2040	\$ 124,742	\$ 72,757
2027	\$ 42,494	\$ 11,273			

Both examples assume the individual has a starting salary of \$40,000, receives 2.5 percent annual increases, defers 5 percent of salary each year, and earns 4 percent interest on those contributions.

Graph 7 displays the cumulative effects of cashing out after ten years of employment over the remaining working career.



These two examples rely on conservative assumptions and present the effects on a worker earning the U.S. median salary. The effects would increase significantly with modest changes in the assumptions. For instance, as the interest rate increases, the accumulation gap between not cashing out and cashing out grows much wider. In addition, if the individual were to defer the maximum amount each year or if the employer provided matching contributions, the effects would also multiply. In each of these cases, the gap widens and the effects on retirement security become more significant.

### ***C. AFFECTING THE MOST VULNERABLE POPULATIONS***

Individuals who hire a financial advisor tend to be higher income and have more general education than other individuals. That is not the case for individuals who contact a call center or broker-dealer associated with their employer's retirement plan. Information that we received from financial services firms suggests that a wide range of individuals utilize this type of service to help them with their retirement savings decisions. For example, one company's call center data for the first quarter of 2013 indicated that nearly 80 percent of the calls related to individuals with no more than \$50,000 of assets in their retirement savings plan and nearly 50 percent of the calls related to individuals with no more than \$5,000 in the plan. Nearly 60 percent of the calls related to individuals under age 50 and more than 60 percent related to individuals with less than 10 years of service with the employer.

One of the greatest risks to long-term retirement savings is the potential for pre-retirement cash outs of retirement savings. Cash-outs are highest among individuals who are younger, have lower wages, and have less tenure with an employer. Higher cash-out rates are also an issue for African-Americans and Hispanics. Assistance provided by call centers and broker-dealers at job termination plays a key role in trying to reduce cash-out rates, particularly among these groups who are least likely to use the services of a paid financial planner. One financial services company indicated that oral communications with employees terminating employment has a significant effect on cash-out rates; employees with account balances between \$35,000 and \$50,000 are approximately 3.2 times less likely to cash out their retirement savings if they receive a call rather than only receiving written communications. As a result, reducing access to call center and broker-dealer assistance will likely disproportionately affect the individuals who are most vulnerable to cash outs.



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## APPENDIX A – TECHNICAL EXPLANATION OF STUDY ESTIMATES

The estimates of increased cash-outs from qualified retirement savings rely on a number of data sources as well as our estimates of the effects of reducing employee access to assistance through call centers and broker-dealers. The estimates attempt to characterize and quantify the potential asset erosion from retirement savings when participants are unable to obtain assistance at job change, when they must make decisions regarding their retirement plan assets.

We first estimate pension participation and IRA contributions by income class. Because cashouts of retirement savings at job change tend to correlate negatively with income (i.e., individuals with higher income are less likely to cash out their retirement savings at job change), we can use the income distribution of pension and IRA participation to help us capture these effects. The Internal Revenue Service Statistics of Income (SOI) data provide the starting point for this step. The SOI presents tabular data based on information collected from matched samples of Form 1040, U.S. Individual Income Tax Return; and Form W-2, Wage and Tax Statement, for Tax Years.

Data from individual income tax returns rely on a stratified probability sample.<sup>47</sup> Information on wages and retirement contributions rely on Forms W-2 matched to the sampled individual income tax return. The individual income tax return provides information on the gender and age of a taxpayer (obtained by matching the primary and secondary Social Security numbers on the individual income tax return to information from the Social Security Administration). Form W-2, box 12 provides detail on the type of retirement plan. The SOI collects this information on an individual taxpayer basis. These estimates retain information on age, gender, filing status, and wage and salary income levels to reflect certain characteristics that are likely to affect account balances.

We impute aggregate balances for the distribution of taxpayers reporting retirement contributions on Form W-2 relying on data from two surveys, which provides an opportunity to verify and corroborate the assumptions applied to the taxpayer characteristics. The first survey is the Survey of Consumer Finances (SCF), a survey of U.S. households sponsored by the Board of Governors of the Federal Reserve System with the cooperation of the U.S. Department of the Treasury every three years. The second survey is the Employee Benefits Research Institute and the Investment Company Institute (EBRI/ICI) survey of retirement plans. The EBRI/ICI survey collects information about individual 401(k) plan participant accounts. As of December 2010, the database included information about 23.4 million 401(k) plan participants in 64,455 employer-sponsored 401(k) plans, representing \$1.414 trillion in assets. In addition, the EBRI/ICI survey collects data from plan recordkeepers and, therefore, is able to capture the characteristics of the plan activity. The survey retains information on demographic, contribution, asset allocation, and loan and withdrawal activity information for millions of participants, which enables estimates of the cumulative changes in account balances. Together, these surveys provide qualitative information that allows imputation of account balances.

From this base, we estimate those qualified plan participants who experience a break in service (through job termination) and face a decision regarding plan assets held with their previous employer. The Job Opening and Labor Turnover Survey (JOLTS) from the Bureau of Labor Statistics provides current statistics on labor turnover by selected worker characteristics. The

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<sup>47</sup> Refer to Statistics of Income—2010, Individual Income Tax Returns documentation for the description of the sampling procedures and data limitations of Statistics of Income tabulations.

JOLTS measures hires and separations on a monthly basis. Historical estimates that correspond with the reference year data (2010) support these estimates.

Finally, we investigate the role of financial planners and brokers in helping workers save for retirement. Our research (described in detail below) relies on a DOL-sponsored pilot survey conducted through the Rand American Life Panel that looks at how current enrollees in employer-sponsored defined contribution (DC) plans make retirement decisions.

### **Rand American Life Panel (ALP)**

Since 2006, the Rand Corporation has fielded a survey of approximately 6,000 individuals who have agreed to participate in occasional, on-line surveys on topics of interest to policymakers. Approximately 350 surveys have been conducted to date on topics as diverse as financial decision-making, financial literacy, self-reported health and well-being and Social Security knowledge. Participants in the ALP are selected from several other, on-going surveys in the United States including the University of Michigan Monthly Survey, the National Survey Project cohort and active recruitment based on the nature of the survey.

Well-Being Survey 189 is a DOL-sponsored pilot survey to ascertain the retirement plans of individuals. The survey was conducted between June and August of 2011 and resulted in 3,061 completed interviews with a response rate of slightly over 85 percent. In addition to a basic core module that provides demographic information on the respondents, the survey also includes modules on:

- Retirement Planning;
- Income and Transfers;
- Assets and Liabilities;
- Retirement Savings Behavior;
- Employer Retirement Savings Plans and Design;
- Financial Literacy; and
- Risk and Time Preferences.

For the purposes of this research, we focus primarily on the demographic characteristics of workers enrolled in employer-sponsored DC plans, plan balances, the investment decisions of the plan participants, indicators of financial literacy, and the decision to rely on a financial planner or broker to assist in retirement decisions.

### **The Model**

For this preliminary research, we constructed an econometric model of plan balances for workers in the Well Being 189 Survey who indicated they were enrolled in a company-sponsored DC plan. We investigate how access to a financial planner might affect retirement savings outcomes. For this purpose, we define plan balances as the sum of (1) current plan balances; (2) balances in plans from prior employers; and (3) any IRA or Keogh plan balances that the respondent may have. Of the 3,061 survey respondents, 837 met our criteria.

We also construct several variables from the Survey that we believe should be strong predictors of retirement savings:

AGE:	The age of the respondent.
AGESQR:	The age of the respondent squared (to capture life-cycle effects).
INCOME:	Total income of the respondent.
CHRONIC:	An indicator if the respondent reported suffering from a chronic disease such as cancer, diabetes or stroke.
TENURE:	An indicator if the respondent owned a home.
FRACTION_STOCK:	The fraction of current plan balance that is invested in stocks.
LITERACY:	An index of financial literacy.
PLANNER:	An indicator if the respondent said he/she relied on a financial planner or broker for assistance.

We expect total plan balances to be positively related to income capturing the fact that a higher income should result in more resources devoted to retirement savings. In contrast, we expect retirement savings to be negatively related to health status (as captured in the CHRONIC variable) as this could mean time spent out of the labor force, reduced hours of work, or other impediments to lifetime earnings. Similarly, we expect retirement savings to be positively related to owning a home (TENURE), suggesting that homeowners may have more resources that can be devoted to saving for retirement.

**Appendix A - Table 1. Description of Variables Used in the Model <sup>1/</sup>**

Name	Description
LNBALANCE	Natural logarithm of total plan balances in 2010. Includes balances of existing plan, plans from prior employment and any IRA or Keogh plans.
AGE	Age of survey respondent.
AGESQR	Age of survey respondent squared.
LNINCOME	Natural logarithm of total income.
CHRONIC	Takes a value of 1.0 if the respondent reports suffering from a chronic illness (e.g., cancer, diabetes) and zero otherwise.
TENURE	Takes a value of 1.0 if the respondent is a homeowner.
FRACTION_STOCKS	The fraction of current plan assets invested in stock.
LITERACY	Index of financial literacy equal to the number of correct responses to survey questions relating to numeracy, inflation and risk diversification.
PLANNER	Takes a value of 1.0 if the respondent indicates he/she has consulted with a financial planner or broken in planning for retirement.

<sup>1/</sup> Variables are calculated from survey questions contained in the American Life Panel, *Well Being Survey 189, DOL Pilot*.

We have no a priori expectation about how the fraction of stock in one's portfolio might affect plan balances. Because stocks generally have higher long-term growth than bonds, we would expect this variable to be positively related to plan balances. On the other hand, because the survey was conducted in mid-2011, those plans with a large stock component could have

suffered from the recent financial crisis. We expect financial literacy to be positively correlated with plan balances to the extent enrollees make better financial decisions relating to their retirement savings. Finally, we expect that plan balances should be positively related to seeking planning advice from a professional advisor.

In order to control for the wide variation and degree of skew in plan balances, we use the natural logarithm of total plan balances as our dependent variable. We also use the natural logarithm of total income as a predictor variable. Appendix Table 1 describes the variables used in our analysis and Appendix Table 2 reports summary statistics for each.

**Appendix A - Table 2. Mean and Standard Deviation of Variables Used in the Model <sup>1/</sup>**

Variable	Mean (N=837)	St. Dev. (N=837)
LNBALANCE	9.9285	2.7615
AGE	47.0824	11.3594
AGESQR	2,345.6400	1,073.7000
LNINCOME	10.8762	1.8997
CHRONIC	0.3154	0.4650
TENURE	0.7790	0.4152
FRACTION_STOCKS	0.7384	0.4398
LITERACY	2.3214	0.9638
PLANNER	0.5317	0.4993

<sup>1/</sup> Variables are calculated from survey questions contained in the American Life Panel, *Well Being Survey 189, DOL Pilot*.

The statistics show that, of our sample of 837 enrolled workers, the average age is 47 years, approximately 32 percent have experienced some type of chronic health problem, 78 percent are homeowners, about 74 percent of current plan balances are in stocks, and slightly more than half consulted with a financial planner.

## Results

Our results are shown in Appendix Table 3. The estimated coefficients conform to our expectations about how certain variables relate to plan balances. The positive coefficient on AGE shows that, at least for our sample, plan balances at first rise with age, as one would expect. In contrast, the negative coefficient on AGESQR indicates that balances begin to increase at a slower rate at some point in the life-cycle, perhaps due to withdrawals or a movement towards safer, fixed-income investments as one gets older.

**Appendix A - Table 3. Estimation Results for Total Plan Balances in 2010 <sup>1/</sup>**  
*(Standard Errors in Parentheses)*

Variable	<u>Dependent Variable</u> LNBALANCE
AGE	0.18585** (0.0406)
AGESQR	-0.0014** (0.0004)
LNINCOME	0.36822** (0.0445)
CHRONIC	-0.1334 (0.1857)
TENURE	0.78026** (0.2058)
FRACTION_STOCKS	1.10525** (0.1999)
LITERACY	0.31658** (0.0939)
PLANNER	0.33368** (0.1666)
Number of Observations	837
Adjusted R-Square	0.2793
F-Value	41.49**

<sup>1/</sup> Coefficient estimates from unweighted, ordinary least squares on employed respondents enrolled in a employer-provided defined contribution plan in 2010.

\* Statistically significant at 90 percent confidence levels.

\*\* Statistically significant at 95 percent confidence levels.

Plan balances correlate positively with income and homeownership as indicated by the positive coefficients on these two variables and correlate negatively with health status. Both these results are expected. The fraction of plan balances held in stocks (FRACTION\_STOCKS) suggests a strong, positive effect on plan balances. As expected, larger plan balances are positively related to financial literacy and the use of a financial planner. Because of the log specification of our model for plan balances, we can interpret the coefficient on PLANNER as indicating that plan balances are about 33 percent higher if an individual consulted a financial planner or broker for financial advice.

All the coefficients in our model, except CHRONIC, are statistically significant at 95 percent confidence intervals. The adjusted R-square of 0.28 is reasonably high for cross section data.

## **Conclusions and Suggestions for Future Research**

Our model of DC plan balances performs quite well. Our parameter estimates supports our theory of how certain variables might influence retirement savings. In particular, having access to a financial planner or broker appears to result in retirement savings in DC plans that are higher by about 33 percent. Our model suggests important life-cycle effects are present in retirement savings with plan balances increasing with age initially and then at decreasing rate as workers approach retirement age.