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The Department of Labor's Proposed Conflict of Interest Rule: Rhetoric vs. Reality

The Impact on Small Investors and Small Employers

Rhetoric:

"Given that the Department is not proposing to ban commissions or other common types of compensation, but rather to require advisers to provide advice that is in their client's best interest, we believe the proposed rule as crafted preserves and expands access to good retirement advice for small savers and helps them lay the groundwork for a secure retirement."

Source: U.S. Department of Labor website: FAQs – Conflict of Interest Rulemaking, Question 14.
Available at: http://www.dol.gov/featured/ProtectYourSavings/faqs.htm.

Reality:

The Department's proposal will neither preserve nor expand access to good retirement advice for small savers. In fact, the proposal, if enacted without substantial changes, will have the opposite effect.

Due in part to the Department's overly broad definition of the term "fiduciary," the limited "carve-outs" and the complexity of the proposed Best Interest Contract exemption, without significant changes to the proposal, there will likely be a dramatic DECREASE in:

- Access to guaranteed lifetime income solutions;
- The number of small business retirement plans;
- Access to important workplace benefits such as life, disability income, long-term care, and other non-medical products; and
- Investment and distribution education and guidance.

Several commenters on the Department's proposal have raised concerns regarding its impact on small retirement savers and small businesses:

- According to the Financial Industry Regulatory Authority (FINRA), the proposed regulation could affect 98% of IRAs with less than $25,000 if comission-based services are largly eliminated from the market-place.
- The National Federation of Independent Businesses believes that the proposals "are likely to have a substantial impact on small businesses," as providers will no longer be able to deliver services to small businesses and their employees in an affordable manner.
- The Small Business Council of America believes that the proposed rules "are likely to have a significant negative impact on the small business retirement plan system and could result in a decline in small business plan formation."
- The United States Small Business Administration Office of Advocacy's comment letter states that small business stakeholders believe that the proposed rule "would likely increase the costs associated with servicing smaller plans sponsored by small business employers."
- The Wisconsin Farm Bureau Federation's comment letter states that, if the proposed rule is enacted as written, "farmers, workers and retirees are at risk of losing valuable advice from knowledgeable, local professionals about investment options and how to plan for retirement."
- The Business Roundtable believes that the proposed rules, if finalized without changes, "could have negative consequences for employee benefits plans and their participants."
- The United States Chamber of Commerce's comment letter states that the proposal will "make it more difficult for America's workers and retirees to access retirement plans, to receive quality investment advice, to receive useful educational information about their plans and investments, and to move their retirement assets freely between employer-provided plans and IRAs."

Several studies of the Department's proposal also raised significant concerns:

- Oliver Wyman's study found that, with respect to IRAs, if the rule is implemented as proposed, millions of existing small balance IRA owners are likely to lose access to the financial adviser of their choice, or any financial adviser at all – and the majority of others will face higher costs when providers shift brokerage accounts to adviser accounts.
- Economists, Inc.'s study found several flaws in the Department's Regulatory Impact Analysis. Specifically, the study found that the Department ignored significant costs to millions of small savers that the rule would impose. The study found that these costs come largely from (1) small savers losing access to human financial advisers (because small accounts would be uneconomic to serve, and expose advisory firms to new risks); (2) small savers being forced into fee-based advisory relationships that cost more than current commission-based arrangements; and (3) small savers and firms not being encouraged to save more, take full advantage of employer matches, or create retirement plans in the first place.

The Sellers' Carve-Out

Rhetoric:

"All of the rule's carve-outs are subject to conditions designed to draw an appropriate line between fiduciary and non-fiduciary communications, consistent with the text and purpose of the statutory provisions."

Source: Definition of the Term "Fiduciary"; Conflict of Interest Rule – Retirement Investment Advice, 80 Fed. Reg. 21929 (April 20, 2015).

Reality:

Neither the seller's carve-out nor the proposed Best Interest Contract exemption are available for services provided to participant-directed plans with less than 100 participants. Therefore, there is no exemption or carve-out that would allow for a sale by an insurance agent to a 401(k) plan with less than 100 participants. The Department's arbitrary determination that plan size is a substitute for understanding one's fiduciary responsibilities under ERISA is wholly unsupported by the text and purpose of ERISA's statutory provisions. The arbitrary line drawn by the Department is far from "appropriate."

2015 Oliver Wyman study shows that small businesses that work with a financial advisor are 50% more likely to set up a retirement plan (and micro businesses with 1-9 employees are almost twice as likely). This regulation will affect how small businesses can offer 401ks and IRAs to their employees—impacting millions of American's retirement security.

Investment Education

Rhetoric:

"The Department's proposal carefully carves out education from the definition of retirement investment advice so that advisers and plan sponsors can continue to provide general education on retirement saving across employment-based plans and IRA's without triggering fiduciary duties"

Source: Fact Sheet: Department of Labor Proposed Rule to Address Conflicts of Interest in Retirement Advice, Saving Middle-Class Families Billions of Dollars Every Year. Available at: http://www.dol.gov/ebsa/newsroom/fsconflictsofinterest.html.

Reality:

The proposed rule would replace a long standing Department of Labor Interpretive Bulletin that addresses non-fiduciary investment education. Specifically, the proposed rule's investment education carve-out would not allow an adviser to provide a retirement investor with asset allocation models or interactive investment materials that refer to specific investment products (or distribution options) available under the retirement investor's specific plan or IRA) without triggering fiduciary status. In reality, instead of expanding investor education, the proposed rule eliminates a long-standing and valuable investor education tool.

Any new regulation should allow advisors to continue to provide for meaningful education and information about retirement savings and income options.

The Proposed "Best Interest Contract Exemption"

Rhetoric:

The proposal "provides a new, broad, principles-based exemption that can accommodate and adapt to the broad range of evolving business practices."

Source: Fact Sheet: Department of Labor Proposed Rule to Address Conflicts of Interest in Retirement Advice, Saving Middle-Class Families Billions of Dollars Every Year. Available at: http://www.dol.gov/ebsa/newsroom/fsconflictsofinterest.html.

Reality:

The proposed "Best Interest Contract Exemption" is far from "principles-based." Instead, the exemption is prescriptive and complex, and requires among its conditions a multitude of detailed contractual representations and warranties, as well as a complicated and costly disclosure regime, that result in the exemption having no utility.

Further, the exemption does not "accommodate and adapt to the broad range of evolving business practices." In practice, the exemption is primarily suited for a business model that does not actually exist among insurance-based financial services institutions - one that does not pay advisers differential compensation for the sale of products.

The Department's Regulatory Impact Analysis

Rhetoric:

"DOL is releasing a more rigorous analysis of the anticipated gains to investors and costs of the rule"

Source: Fact Sheet: Department of Labor Proposed Rule to Address Conflicts of Interest in Retirement Advice, Saving Middle-Class Families Billions of Dollars Every Year. Available at: http://www.dol.gov/ebsa/newsroom/fsconflictsofinterest.html.

Reality:

The Department's Regulatory Impact Analysis (RIA) is far from "rigorous," and is, in fact, substantially flawed. Although the RIA acknowledges that 31 percent of IRAs include investments in annuities, the RIA makes no attempt to examine the impact of the proposed rule on insurers, the annuity market, or on the availability of lifetime income, nor does it attempt to assess the value of variable annuities or their role in retirement security. The proposed rule mentions annuities 172 times. Yet, the RIA contains no mention of the rule's impact on annuities. Further, none of the studies included in the RIA support the Department's assertion that fiduciary-advised accounts perform better than other types of accounts.

The Department relied only on two comment letters to estimate the cost of a significant new regulation on life insurers—a $24.7 trillion industry. This is both insufficient and far from "rigorous."

Finally, among other flaws, the RIA completely excludes the protections of the current regulatory framework for annuitants in its evaluation of the need for the proposed rule.

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