Nevadans Can Take a Stand Against Conflicted Financial Advice

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Thank you for giving me the opportunity to speak today. My name is Joe Valenti, and I am the Director of Consumer Finance at the Center for American Progress in Washington, D.C. Today, I will discuss Senate Bill 383[1] in the context of the Trump administration's recent delay of a federal rule by the U.S. Department of Labor, or DOL, to regulate financial advice; the reasons why impartial financial advice is so crucial to savers and retirees; and some of the unfounded criticisms of a higher standard for financial advice.

Last year, the DOL released a final rule to close long-standing loopholes that allow retirement investment advisers to put their commissions before their clients' best interest.[2] The DOL spent six years developing this rule with extensive public comment. On April 10—just two days ago—the rule was expected to begin applying to retirement investment advice. Instead, following a February 3 presidential memorandum by the Trump administration, the DOL is delaying implementation of the rule for at least 60 days and could make further changes as part of a broader reconsideration of all financial regulations.[3] This unnecessary delay costs investors approximately $46 million per day.[4]

I mention this context because Nevadans know all too well the consequences of unscrupulous financial practices. Nearly 10 years after the start of the Great Recession, too many scars of the foreclosure crisis remain. Homebuyers were all too often lured by salespeople offering deceptive and often toxic mortgage products in which companies continued to profit while families struggled to keep up with payments and faced foreclosure. Homeowners placed trust in these institutions and were ultimately let down when their interests were not, in fact, put first.

For four decades, we have seen a similar story unfold in retirement advice. Families are increasingly on their own to achieve retirement security and other financial goals, even as the costs of basic pillars of a middle-class life have increased.[5] The stakes could not be higher: Across the country, more than half of all working-age families are at risk of an insecure retirement.[6] Fifty-five percent of Nevadans who have not yet retired worry about running out of money when they do.[7] With most retirement savings held in 401(k) plans and individual retirement accounts, or IRAs, it's not surprising that workers and retirees often turn to financial professionals for help in managing the trillions of dollars in these accounts. And they have high expectations: 87 percent of retirement investors in one recent survey considered it "very important" or "somewhat important" for their financial adviser to be legally required to act in investors' best interests.[8]

Yet all too often, what customers receive is a sales pitch disguised as impartial advice. When advisers are paid based on the types of investments they sell, they may earn double the commission—or even more—for recommending one financial product over another, even if another product would be more appropriate.[9] The kickbacks can be quite lucrative: Selling certain insurance products could earn an adviser a Caribbean cruise.[10] But the recipients of this advice do not fare nearly as well.

Some customers simply end up paying too much. Consider cases involving former federal employees, including veterans. The federal retirement plan, known as the Thrift Savings Plan, has been called "the best retirement plan ever" and "a model for others to follow."[11] But participants are frequently targeted by companies convincing them to move their funds out of the plan, paying fees that are at least 20 times higher than if they left the money alone.[12] Over time, even small differences in fees matter enormously. A young worker who pays 75 basis points, or 0.75 percent, more in investment fees over a lifetime would need to work three years longer just to achieve the same level of retirement income.[13]

In other cases, customers end up in dangerous investments they never should have had in the first place. Elaine and Merlin Toffel, an elderly couple in Illinois, walked into their local bank branch to get help with some low-cost investment accounts. Their accounts only needed modest changes, but they ended up instead in expensive variable annuities that incurred costly tax consequences and made it harder to pay for long-term care.[14]

Meanwhile, advertising for financial advice clearly implies that companies put their customers first. In one recent analysis of 25 firms affected by the DOL rule, each firm publicly called its employees financial advisers and created the expectation that they provide retirement planning rather than product sales.[15] These expectations do not match the fine print. Under the 1975 regulation that the federal DOL sought to modernize, advisers could state, for example, that their advice was not the primary basis of an investment decision, that the two parties did not have a mutual agreement, or that it was only one-time advice.[16] But the consequences could have major and permanent ramifications.

Customers expect better: They are looking for financial advice, not buying a toaster. That's why it is crucial to end the loopholes that hold one category of financial professionals to a standard of providing impartial financial advice while letting others call themselves advisers despite their conflicted sales pitches.

Some have argued that these types of policies will result in higher costs or decreased access.[17] These claims are false. Customers will be charged transparently for the advice they receive, instead of having supposedly free financial advice while hiding years of fees that they may never notice. The industry has begun to adjust to these new realities. Thomas Powers, a 75-year-old investor, was recently told by his firm that he would need to switch to a fee-based account charging 1 percent per year because of the rule—until he threatened to move his money elsewhere and his fee fell to 0.3 percent.[18] Similarly, Rebalance IRA, a relatively new firm, offers advice on a platform that reduces the average customer's fees by 68 percent.[19] As we have seen across financial products such as mortgages and consumer loans, fears of constrained access all too often hide the true nature of products being offered.[20] Expensive, conflicted advice only leaves families, communities, and ultimately taxpayers paying the price for financial insecurity. Nationally, $181 billion each year goes to tax breaks for retirement savings[21]—dollars that should help Americans' financial futures and not just pad financial industry pockets.

As Washington, regrettably, continues to reconsider how to regulate financial advice, Senate Bill 383 would allow the state of Nevada to take a stand against conflicted financial advice that costs savers too much and gives them too little. Thank you. I look forward to your questions.

Joe Valenti is the Director of Consumer Finance at the Center for American Progress.

Endnotes

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