



# The Fiduciary Rule Would Put Savers' and Retirees' Best Interests First

Testimony Before the U.S. Department of Labor

Hearing on Proposed Conflict of Interest Rule,  
Proposed Exemptions and Regulatory Impact Analysis

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Good morning. I would like to thank the U.S. Department of Labor for holding this week's hearings. 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 address the challenges workers face in planning for a secure retirement; the need for a strong rule to prevent conflicted retirement investment advice; and some of the proposed rule's unfounded criticisms.

The stakes for workers and retirees today are far higher than they were four decades ago. When the current so-called suitability standard was established in 1975, nearly three-quarters of all workers in a retirement plan were participants in defined benefit pensions.<sup>1</sup> Today, most Americans' retirement savings lies instead in vehicles such as 401(k) plans and individual retirement accounts, or IRAs.<sup>2</sup> Families are largely on their own to make major investing and retirement planning decisions. And the record shows many of them have had great difficulty doing so.

While most households have access to Social Security, many also rely on pensions and savings that are already weak. Among households age 55 to 64 with retirement plans, the median account balance is only \$104,000—which would only provide about \$5,000 in annual income as a life annuity.<sup>3</sup> Including households with no retirement savings at all, the median account balance drops to \$14,500. More than half of working-age households are now considered inadequately prepared for retirement, an increase from 31 percent in 1983.<sup>4</sup> This risk is even higher for African American and Latino households, those without a high school diploma, and households headed by single women.<sup>5</sup>

Consequently, it's important that families can turn to financial professionals to help them chart a course for retirement. However, such professionals are only a benefit to families if they provide the best advice for the saver rather than for their own earnings. In other words, this advice must meet the highest standard for a relationship of trust: a fiduciary standard. Unfortunately, the current suitability standard, which is four decades old, reflects a lower standard of care. It ignores the significant long-term consequences of even one-time advice and enables contracts to imply in fine print that these are not binding relationships of trust. As a result, broker-dealers and others are able to market themselves as financial advisers or consultants without actually complying with the rules that normally govern such relationships. Moreover, as has been frequently stated this week, savers enter into these contracts expecting them to signify fiduciary relationships.

When families do turn to financial professionals, the suitability standard has major consequences for retirement savers through high fees and potential abuse. The market for IRAs is a prime example. Today, the \$7.4 trillion in IRA assets even exceed those in 401(k) plans.<sup>6</sup> The vast majority of these funds come from rollovers when workers change jobs or retire. As the Government Accountability Office recently found, workers leaving a job who sought advice were often “highly encouraged” to convert to a high-cost IRA even if they could stay in their plan or move their savings to their new employer’s plan.<sup>7</sup>

Even workers in the federal Thrift Savings Plan, or TSP—the lowest-cost plan imaginable—have been subject to marketing disguised as advice. Nearly half of all federal employees take money out of the TSP when they leave the government despite the fact that other plans have fees that are at least 20 times higher.<sup>8</sup> These migrations are extremely costly as fees compound over time. Even a 75 basis point, or 0.75 percent, difference in fees for a young worker could result in \$100,000 of additional fees across a lifetime. That’s equivalent to working three additional years to achieve the same retirement income.<sup>9</sup>

What’s more, conflicted advice often carries significant consequences beyond excessive investment and plan management fees. Consider Elaine and Merlin Toffel of Illinois, whose story was reported last year in *The New York Times*. After meeting with brokers at their trusted local bank branch, they sold a portfolio of low-cost investments—incurring tax consequences along the way—and invested most of their money in expensive variable annuities recommended by the bank, with a 4 percent annual fee and a 7 percent surrender charge for accessing funds early. The surrender fee made it difficult for the Toffels to use these assets to cover long-term care needs. An advisor acting in their best interest likely would have instead recommended modest investment changes.<sup>10</sup>

These abuses demonstrate the need for the Department of Labor’s proposed rule.

While a fiduciary standard would require market adjustments, giving conflict-free retirement advice is not unworkable. Thirty million investors are currently served by registered investment advisers who manage \$67 trillion under a legal obligation to serve

the best interest of their clients.<sup>11</sup> And, increasingly, firms are using technology to offer advice under a fiduciary standard at a fraction of the cost of the conflicted advice available today. Rebalance IRA, for example, reports that the average new customer coming from a brokerage relationship previously incurred an average total fee exceeding 2.37 percent per year.<sup>12</sup> After becoming a Rebalance customer, customers' fees declined on average by 68 percent. In any other industry, this development would be called innovation or disruption, rather than being dismissed as so-called robo advice.

Many have argued that small savers' needs will no longer be met through the department's proposed rule.<sup>13</sup> As someone whose work focuses on consumer policies that support low- and moderate-income Americans, I disagree. Instead, I agree with Arthur Levitt, the former Securities and Exchange Commission Chairman, who recently stated that, "I think people of modest means are the ones who need this rule more than any other type of investor."<sup>14</sup> Industry warnings about losing access are often a red herring, as we have seen in efforts to restrict predatory or misleading credit products, such as high-cost mortgages and auto loans.<sup>15</sup> And when families cannot achieve a secure retirement, taxpayers collectively pay the price.

Some have also speculated that enhanced disclosures alone could address this need. Notably, the proposed Best Interest Contract Exemption, a safe harbor, contains several key disclosures that could potentially empower consumers to identify fees in a clear and comprehensible manner. CAP strongly supports prepurchase disclosures that illustrate the consequences of fees not just in one year, but also the effects of compounding over a 20-year period. And CAP also supports the development of a "Retirement Receipt," an annual disclosure of a retirement account's investment and administrative fees in dollar terms.<sup>16</sup> In fact, the Department of Labor should consider adopting similar disclosures for all retirement accounts, not just those under the exemption.

Yet, if the proposed rule focuses only on disclosure—as some have argued it should—it will have missed the point. Additional information can help savers and retirees make comparisons and identify where their hard-earned dollars are going. But when savers enter into a perceived relationship of trust, they should not have to worry that their advisor is serving his or her own financial needs instead of their needs. That's why it is essential for the Department of Labor to create a legal obligation for all financial professionals in the retirement marketplace to act in their clients' best interest. Thank you for the opportunity to testify today; I look forward to our continued dialogue on this rule.

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## Endnotes

- 1 Center for American Progress tabulations of Employee Benefits Security Administration, *Private Pension Plan Bulletin Historical Tables and Graphs* (U.S. Department of Labor, 2014), Table E5, available at <https://www.dol.gov/ebsa/pdf/historicaltables.pdf>. These tabulations likely understate the magnitude of the shift toward defined contribution plans because the statistics double-count individuals who participate in both types of plans.
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- 3 Keith Miller, David Madland, and Christian E. Weller, "The Reality of the Retirement Crisis" (Washington: Center for American Progress, 2015), available at <https://www.americanprogress.org/issues/economy/report/2015/01/26/105394/the-reality-of-the-retirement-crisis/>.
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- 10 Tara Siegel Bernard, "Before the Advice, Check Out the Adviser," *The New York Times*, October 10, 2014, available at <http://www.nytimes.com/2014/10/12/business/mutfund/before-the-advice-check-out-the-adviser.html>.
- 11 National Regulatory Services, "A Profile of the Investment Adviser Profession—Evolution Revolution 2015," available at <http://www.nrs-inc.com/EvolutionRevolution2015> (last accessed August 2015).
- 12 Rebalance IRA Managing Director Scott Puritz, "Restricting Advice and Education: DOL's Unworkable Investment Proposal for American Families and Retirees" Testimony before the Senate Health, Education, Labor and Pensions Committee, Subcommittee on Employment and Workplace Safety, July 21, 2015, available at <http://www.help.senate.gov/imo/media/doc/Puritz.pdf>.
- 13 Robert Litan and Hal Singer, "Obama's Big Idea for Small Savers: 'Robo' Financial Advice," *The Wall Street Journal*, July 21, 2015, available at <http://www.wsj.com/articles/obamas-big-idea-for-small-savers-robo-financial-advice-1437521976>.
- 14 U.S. Department of Labor, "Arthur Levitt: Move Forward on the Fiduciary Standard," YouTube, May 18, 2015, available at <https://www.youtube.com/watch?v=7zycY3rn6pc>.
- 15 For example, see, Joe Valenti, Sarah Edelman, and Julia Gordon, "Lending for Success" (Washington: Center for American Progress, 2015), available at <https://www.americanprogress.org/issues/economy/report/2015/07/13/117020/lending-for-success/>.
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