

FACT SHEET: Middle Class Economics: Strengthening Retirement Security by Cracking Down on Conflicts of Interest in Retirement Savings

“For Americans who are doing the hard work of saving for retirement, let’s make sure that they get a fair deal.” – President Barack Obama, White House Conference on Aging, July 13, 2015

Middle class economics means that Americans should be able to retire with dignity after a lifetime of hard work. But today, the rules of the road do not ensure that financial advisers act in their clients’ best interest when they give retirement investment advice. Instead, some firms incentivize advisers to steer clients into products that may have higher fees and lower returns. These conflicts of interest in retirement advice cost America’s families an estimated \$17 billion a year.

That’s why today, at President Obama’s direction, the Department of Labor (DOL) is finalizing a rule and related exemptions to ensure that retirement savers get investment advice in their best interest, so they can grow their nest egg and be better prepared for retirement. These rules will save affected middle-class families tens of thousands of dollars for their retirement over a lifetime of savings. And they’ll level the playing field for the many good actors, so that retirement advisers will compete based on the quality of advice they give.

Since DOL issued its first proposal in 2010 and its second proposal last April, the Administration has received extensive feedback from industry, advocates, Congress, federal and state regulators, and others. The rule being released today reflects this input and is better for it. DOL has streamlined the rule and exemptions to reduce the compliance burden and ensure continued access to advice, while maintaining an enforceable best interest standard that protects consumers.

Today’s announcement is another critical step in the President’s ambitious effort to put in place the strongest consumer protections in American history, while fighting back efforts by Wall Street and their allies to hinder the progress we have made. These new retirement protections add to stronger rules of the road for mortgages, credit cards, and student loans, among others.

- Conflicts of Interest in Retirement Advice Are Hurting the Middle Class: The White House Council of Economic Advisers (CEA) finds conflicts of interest lead, on average, to:

- o 1 percentage point lower annual returns on retirement savings.
- o \$17 billion of losses every year for America’s families.

- President Obama Is Cracking Down on Conflicts of Interest: Today, the DOL is finalizing rules requiring retirement investment advisers to meet a “fiduciary” standard—putting their clients’ best interest before their own profits. These reforms will save affected middle-class families tens of thousands of dollars in retirement savings over a lifetime of saving and level the playing field for the many financial advisers who are already doing right by their clients.

- Final Rule and Related Exemptions Reflect Significant Changes Based on Comments Received: Following its proposal in April 2015, DOL conducted a comment period lasting over 5 months and received extensive feedback through 4 days of public hearings, over 3,000 comments, and more than 100 meetings. Based on this input, DOL has streamlined and simplified the rule to minimize the

compliance burden and ensure ongoing access to advice, while maintaining an enforceable best interest standard that protects savers.

Conflicts of Interest in Retirement Advice Cost Savers Billions of Dollars

Since Congress enacted the Employee Retirement Income Security Act (ERISA) in 1974, there has been a dramatic shift from employer-sponsored defined benefit plans to self-directed IRAs and 401(k)s. These changes have increased the need for good retirement advice, yet until today the ERISA rules governing retirement investment advice had not been meaningfully updated since 1975. While many investment advisers acted in their customers' best interest, not everyone was legally obligated to do so. Instead, the broken regulatory system had allowed misaligned incentives to steer customers into investments that have higher fees or lower returns—costing some middle-class families tens of thousands of dollars of their retirement savings.

Analysis by the President's Council of Economic Advisers last year showed that:

- Working and middle class families receiving conflicted advice earn returns roughly 1 percentage point lower each year (for example, conflicted advice reduces what would be a 6 percent annual return to a 5 percent return).
- An estimated \$1.7 trillion of IRA assets were invested in products that generally provide payments that generate conflicts of interest. Thus, CEA estimated that the aggregate annual cost of conflicted advice is about \$17 billion each year.
- A typical worker who receives conflicted advice when rolling over a 401(k) balance to an IRA at age 45 will lose an estimated 17 percent from her account by age 65. In other words, if a worker has \$100,000 in retirement savings at age 45, without conflicted advice it would grow to an estimated \$216,000 by age 65 adjusted for inflation, but if she receives conflicted advice it would grow to \$179,000—a loss of \$37,000 or 17 percent.

Rule Ensures Retirement Savers Get Advice in Their Best Interest

Today's rule and related exemptions will ensure retirement savers get advice in their best interest, while minimizing the compliance burden on the many advisers who already put their clients' best interest first. The rule defines fiduciary investment advice, while the accompanying exemptions allow advisers and their firms to continue to receive most common forms of compensation if they put their clients' best interest first. The rulemaking package also includes a regulatory impact analysis outlining the monetary harm caused to retirement investors from conflicted advice and the expected economic impacts of the rule.

The rule requires more retirement investment advisers to put their client's best interest first, by expanding the types of retirement advice covered by fiduciary protections. Today large loopholes in the definition of retirement investment advice expose many middle-class families, and especially IRA owners, to advice that may not be in their best interest. Under the rule, any individual receiving compensation for making investment recommendations that are individualized or specifically directed to a particular plan sponsor running a retirement plan (e.g., an employer with a retirement plan), plan participant, or IRA owner for consideration in making a retirement investment decision is a fiduciary.

Being a fiduciary means that the adviser must provide impartial advice in their client's best interest and cannot accept any payments creating conflicts of interest unless they qualify for an exemption intended to assure that the customer's interests are protected. This change expands protections to IRA owners and people rolling over their savings into an IRA from a 401(k), who now must receive investment advice in their best interest.

- The rule clarifies what does and does not constitute fiduciary advice. The rule includes examples of communication that would not rise to the level of a recommendation and thus would not be considered advice. It specifies that education is not included in the definition of retirement investment advice so advisers and plan sponsors can continue to provide general education on retirement saving without triggering fiduciary duties.
- The exemptions will allow firms to accept common types of compensation – like commissions and revenue sharing payments – if they commit to putting their client's best interest first. Under the best interest contract (BIC) exemption, firms (and their individual advisers) can continue to receive most common forms of compensation for advice to retail customers and small plan sponsors to invest in any asset so long as the firms:
 - o Commit the firm and adviser to providing advice in the client's best interest, charge only reasonable compensation, and avoid misleading statements about fees and conflicts of interest.
 - o Adopt policies and procedures designed to ensure that advisers provide best interest advice, and prohibiting financial incentives for advisers to act contrary to the client's best interest.
 - o Disclose conflicts of interest. The firm must direct the customer to a webpage disclosing the firm's compensation arrangements and make customers aware of their right to complete information on the fees charged.

The final package also revises existing exemptions, including limiting the so-called “insurance exemption” to recommendations of “fixed rate annuity contracts.” To sell other insurance products like variable and indexed annuities, firms can use the BIC exemption. New preamble language emphasizing that fees are not the only factor in making investment decisions and giving firms more flexibility on how to comply with disclosure provisions should also make it easier for insurance firms to recommend their products.

- The rule and exemptions ensure that advisers are held accountable to their clients if they provide advice that is not in their clients' best interest. If advisers and firms do not adhere to the standards established in the exemption, retirement investors will be able to hold them accountable—either through a breach of contract claim (for IRAs and other non-ERISA plans) or under the provisions of ERISA (for ERISA plans and participants).

Final Rule and Exemptions Contain Significant Changes Based on the Feedback Received

In addition to the public input on its 2010 Proposal, following its proposal in April 2015, DOL conducted a comment period lasting over 5 months and received extensive feedback in 4 days of public hearings, over 3,000 comment letters (as well as over 300,000 petitions), and more than 100 meetings with stakeholders.

Specifically, among other things, the Department has:

- Further clarified what constitutes fiduciary advice. The final rule defines a variety of investment education activities that fall short of fiduciary conduct, and makes clear that advisers do not act as fiduciaries merely by recommending that a customer hire them to render advisory or asset management services. The final rule also expressly provides that investment advice does not include communications that a reasonable person would not view as an investment recommendation, including general circulation newsletters, television, radio, and public media talk show commentary, remarks in widely attended speeches and conferences, research reports prepared for general circulation, general marketing materials, and general market data. Under the final rule, all appraisals (as opposed to just ESOP appraisals in the proposal) will not be considered advice for purposes of this rule but will be reserved for a future rulemaking.
- Made best interest contract (BIC) exemption available for more advice. Comments expressed concerns that advisers and firms could not take advantage of the BIC exemption if they were recommending proprietary products. Additionally, commenters asked the Department to expand the proposed exemption to apply to products not listed in the exemption (such as listed options and non-traded REITs), and to permit recommendations to sponsors of participant-directed plans like 401(k)s. In response, the final rule and exemptions reflect the following changes:
 - o Advisers recommending any asset—not just those on an asset list included in the proposal—can take advantage of the BIC exemption to continue receiving most common forms of compensation.
 - o BIC exemption will be available for advice to small businesses that sponsor 401(k) plans, as well as for advice to IRA customers and plan participants. Additionally, under the final rule, recommendations to plan sponsors managing more than \$50 million in assets (vs. \$100 million in the proposed rule) will not be considered investment advice if certain conditions are met and hence will not require an exemption.
 - o BIC exemption includes special provisions clarifying how it can be used for recommendation of proprietary products, including a requirement that firms determine that the limitations are not so severe that the adviser will generally be unable to satisfy the exemption’s best interest standard and other requirements.
- Streamlined and simplified requirements of BIC exemption. Responding to feedback from commenters, the Department has taken a number of steps to streamline the BIC exemption to lower compliance costs for firms implementing it and ensure that firms can continue offering commission-based advice to clients for whom it is the best option.
 - o Eliminates the contract requirement for ERISA plans and their participants and beneficiaries. Firms must acknowledge in writing that they, and their advisers, are acting as fiduciaries when providing investment advice to the plan, participant, or beneficiary, but no contract is required.
 - o For advice to IRA holders, provides firms flexibility on when to enter into the contract. Some commenters expressed concerns that advisers would need to present a contract as soon as someone walks in the door – before they’ve even decided whether to hire that adviser. The final exemption makes clear that is not the case. Rather, the contract can be signed at the same time as other account

opening documents. However, any advice given before the contract was signed must be covered by the contract and also meet a best interest standard. The exemption also permits existing clients to agree to the new contractual protections by “negative consent.”

- o Minimizes number of contractual parties. While the proposal required the firm, advisers, and client to be parties to the contract – which could be difficult in situations like call centers where the customer speaks to multiple advisers at a firm – the final exemption simplifies the contract requirement so that it is only between the firm and the client. There does not have to be a new contract for each interaction with a different employee of the same firm, minimizing the burden on firms.

- o Significantly streamlines and simplifies the required disclosures. Firms commented that the types of disclosure envisioned by the proposed best interest contract exemption, in particular the transaction disclosure requiring 1-, 5-, and 10-year projections, would be difficult and costly. Under the final exemption, the transaction disclosure is simplified to focus on the firm’s conflicts of interest, the website disclosure is streamlined but still designed to enable third parties to help customers evaluate different firms’ practices that may affect advisers’ conflicts of interest, and the annual disclosure is eliminated entirely. Clients can also request more detailed disclosures on costs and fees; that way, they can get the information they need at less cost to firms.

- o Eliminates data retention requirements. Some commenters expressed concerns that, under the proposal, firms would be required to retain detailed data on inflows, outflows, holdings, and returns for retirement investors. Now firms have to retain only the records that show they complied with the law (in this case, the BIC exemption), as they would in other situations.

- o BIC exemption contains a streamlined “level fee” provision, which enables advisers and firms that receive only a “level fee” in connection with the advice they provide to rely on the exemption without entering into a contract so long as special attention is paid and documentation is kept to show that certain specific recommendations, including a recommendation to rollover assets from an employer plan to an IRA, are in the customer's best interest. Level fee fiduciaries receive the same compensation regardless of the particular investments the client makes (e.g. they may be compensated based on a fixed percentage of assets under management or a fixed dollar fee) and are not compensated based on commissions or transaction fees.

Grandfathered existing investments. Responding to comments, the BIC exemption includes a grandfathering provision that allows for additional compensation from previously acquired assets. The grandfather provision includes recommendations to hold, as well as systematic purchase agreements, but requires that additional advice satisfy basic best interest and reasonable compensation requirements.