BROOKINGS

1775 Massachusetts Avenue, NW
Washington, DC 20036
telephone 202.797.6000
fax 202.797.6004
web brookings.edu

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Secretary Thomas E. Perez
U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20201
Via: e-ORI@dol.gov

Re: Conflicts of Interest Proposed Rule

Dear Secretary Perez:

Thank you for your efforts to protect American workers from conflicted interest in retirement investment advice. The problem of retirement insecurity is a very serious one, especially as our lifespans increase and the shift from defined benefit plans to defined contribution plans continues. This is important work and I appreciate your efforts to ensure that workers can look forward to a comfortable rather than impoverished retirement.

I am pleased for the opportunity to comment on the proposed conflict of interest rule. The attached comment is co-authored with my colleague Sarah Holmes. It is important to make sure that retirement advisors face the right incentives and place customer interests first. It is also important to make sure that small-scale savers can access good advice so that they can make good decisions and avoid costly mistakes.

Implications for small-scale savers. The proposed rule will bring with it increased compliance costs. These costs, combined with a reluctance to assume more risk and a fear of litigation, may make some advisors less likely to offer retirement advice to households with modest savings. These households are the ones most in need of direction and education, but because their accounts will not turn profits for advisors, they may be abandoned. According to the Employee Benefits Security Administration (EBSA), the proposed rule will save families with IRAs more than $40 billion over the next decade. However, this benefit must be weighed against the attendant costs of implementing the rule. It is possible that the rule will leave low- and medium-income households without professional guidance, further widening the retirement savings gap. The Department of Labor should consider ways to minimize or manage these costs. Options include incentivizing advisors to continue guiding small-scale savers, perhaps through the tax code, and promoting increased financial literacy training for households with modest savings.

Clarifications about education versus advice. The proposed rule distinguished education from advisement. An advisor can share general information on best practices in retirement planning, including making age-appropriate asset allocations and determining the ideal age at which to retire, without triggering fiduciary responsibility. This is certainly a useful distinction. However, unsavory advisors could frame this general information in a way that encourages clients to make decisions that are not in their own best interest. I encourage the Department of Labor to think carefully about the line between education and advice, and how to discourage advisors from sharing information in a way that leads to future conflicts of interest. One option may be standardizing the general information that may be provided without triggering fiduciary responsibility.

Implications for risk management. Earlier in this letter I mentioned that under the proposed rule advisors may be reluctant to assume additional risk and worry about litigation. In addition to pushing small-scale savers out of the market, I also worry that the rule may encourage excessive risk aversion in some advisors. General wisdom suggests that young savers should have relatively high-risk portfolios, de-risking as they age, and ending with a relatively low-risk portfolio at the end of the accumulation period. The proposed rule could cause advisors to discourage clients from taking on risk, even when the risk is generally appropriate and the investor has healthy expectations. Extreme risk aversion could decrease both market returns for investors and the "value-add" of professional advisors. I suggest that the Department of Labor think carefully about how it can discourage conflicted advice without encouraging overzealous risk reductions.

The proposed rule is an important effort to increase consumer protection and retirement security. However, in its current form, it may open the door to some undesirable or problematic outcomes. With some thoughtful revisions, I believe the rule can provide a net benefit to the country.

This letter and the attached comments reflect the opinions of the authors and should not be attributed to the staff, officers, or trustees of the Brookings Institution.

Best regards,

Martin Neil Baily
Senior Fellow, The Brookings Institution
Former Chairman, Council of Economic Advisers (1999-2001)

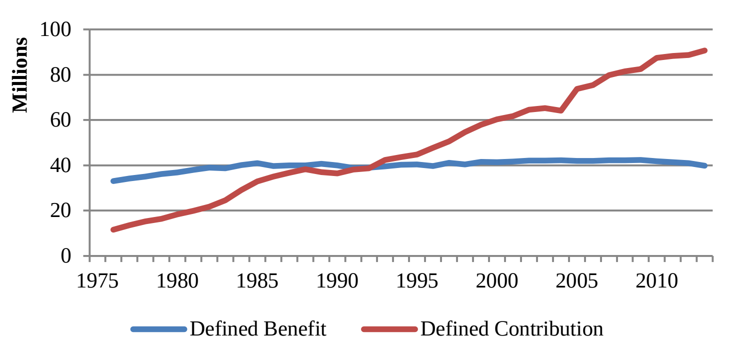
Serving the Best Interests of Retirement Savers:
Framing the Issues

Martin Neil Baily and Sarah E. Holmes
The Brookings Institution[1]

Introduction

Americans are enjoying longer lifespans than ever before. Living longer affords individuals the opportunity to make more contributions to the world, to spend more time with their loved ones, and to devote more years to their favorite activities – but a longer life, and particularly a longer retirement, is also expensive. The retirement security landscape is evolving as workers, employers, retirees, and financial services companies find their needs shifting. Once, many workers planned to stay with a single employer for most or all of their careers, building up a sizeable pension and looking forward to a comfortable retirement. Today, workers more and more workers will be employed by many different employers. Additionally, generous defined benefit (DB) retirement plans are less popular than they once were – though they were never truly commonplace – and defined contribution (DC) plans are becoming ever more prevalent. Figure 1, below, shows the change from DB to DC that has occurred over the past three decades.

Figure 1. Number of Participants in Pension Plans, by type of plan, 1975-2012



Source: Department of Labor (2014).

[1] Baily is a Senior Fellow in Economic Studies where Holmes is a research assistant. This paper is written as part of Brookings ongoing research into financial regulation issues and policies. This research is funded from a variety of sources in the form of unrestricted contributions to the Economic Studies Program, including foundations, individuals and companies, both financial and non-financial. The views expressed are the authors own and do not necessarily reflect Brookings staff and trustees. This research was carried out over a quicker timetable than normal and the usual fact-checking period has been compressed. Baily is a Director of The Phoenix Companies that sell life insurance and annuities. This paper will not discuss either of these investments.

In the past many retirees struggled financially towards the end of their lives, just as they do now, but even so, the changes to the retirement security landscape have been real and marked, and have had a serious impact on workers and retirees alike. DB plans are dwindling, DC plans are on the rise, and as a result individuals must now take a more active role in managing their retirement savings. DC plans incorporate contributions from employees and employers alike, and workers much choose how to invest their nest egg. When a worker leaves a job for retirement or for a different job he or she will often roll over the money from a 401(k) plan into an Individual Retirement Account (IRA). While having more control over one's retirement funds might seem on its face to be a net improvement, the reality is that the average American lacks the financial literacy to make sound decisions (SEC 2012).

The Council of Economic Advisers (CEA) expressed concern earlier this year that savers with IRA accounts may receive poor investment advice, particularly in cases where their financial advisors are compensated through fees and commissions. "[The] best recommendation for the saver may not be the best recommendation for the adviser's bottom line" (CEA 2015). President Obama echoed these concerns in a speech at AARP in February, asking the Department of Labor (DoL) to update its rules for financial advisors to follow when handling IRA accounts (White House 2015). The DoL receives its authority to craft such rules and requirements from the 1974 Employee Retirement Income Security Act (ERISA) (DoL 2015a).

The DoL recently proposed a regulation designed to increase consumer protection by treating some investment advisors as fiduciaries under ERISA and the 1986 Internal Revenue Code (DoL 2015b). The proposed rule has generated heated debate, and some financial advisors have responded with great concern, arguing that it will be difficult or impossible to comply with the rule without raising costs to consumers and/or abandoning smaller accounts that generate little or no profit. Advisors who have traditionally offered only the proprietary products of a single company worry that the business model they have used for many years will no longer be considered to be serving the best interests of clients.

Rather than offering detailed comments on the DoL proposals, this paper will look more broadly at the problem of saving for retirement and the role for professional advice. This is, of course, a welltravelled road with a large literature by academics, institutions and policy-makers, however, it is worthwhile to think about market failures, lack of information and individual incentives and what they imply for the investment advice market.

What Do Retirement Savers Need?

Planning for retirement includes two distinct phases: (1) accumulation of assets during one's working years, and (2) decumulation of assets during retirement, with the goal of using the financial resources without running out of money. Most households accumulate benefits from a variety of sources, usually some combination of employer-sponsored DB and DC plans, IRAs, longevity and long-term-care (LTC) insurance, and Social Security. The amount necessary to live comfortably throughout retirement depends on several variables, including retirement age, pre-retirement earnings, desired standard of living, and medical and LTC expenses. However, even when savers set a goal for their retirement savings, they are unlikely to meet that goal by the time they reach retirement age. Workers estimate that they will need to accumulate $1,000,000 in savings by the time they retire, but the median retirement savings for a worker over age 60 is just $172,000. Less than 40 percent of workers over age 60 have saved $250,000 or more for retirement (TCRS 2015). Just 15 percent of workers have a written retirement strategy, and over 80 percent of workers plan to work, or are already working, past age 65. Some of them do not expect to retire at all (TCRS 2015). Woolley (2015) paints an especially dismal picture: workers between the ages of 55 and 64 have a median retirement account balance of $104,000. Households in that age group without retirement accounts have on average only $14,500 in savings.

Many Americans are not adequately prepared for retirement and the first prescription for this problem is that households need to save aggressively during the accumulation phase and spend carefully during the decumulation phase. Without these practices in place, households are unlikely to be able to support themselves comfortably in retirement, especially in light of our ever-lengthening life expectancies. A related second goal is age-appropriate investing which can provide strong inflationadjusted returns but also guard against excessive risk. In fact it is this second issue of returns that is the focus of the Administration's concern.

A third important aim is to get value for money when professional advice is used. Fees on retirement accounts are generally levied in one of two ways, either as a load fee, an amount that is paid up front, or a wrap fee. A 2 percent load fee means that if a saver puts in $100, only $98 is actually placed into the retirement fund, the other $2 is taken as a fee. Load fees range from 2 percent up to around 5 percent for small accounts. This may also apply to additional amounts added to the fund. Wrap fees are paid each year as a percent of the asset value and they cover the expenses of a fund as well as payments to an adviser. Wrap fees vary substantially from a low of about 50 bps (half a percentage point) up to 200 bps or more. A load fee basically reduces the final value of the retirement portfolio proportionally to the fee, a 5 percent load fee becomes a 5 percent smaller final retirement fund. Wrap fees may seem to take less of the investor's funds, but that is not usually the case. John Bogle (2013) the founder of Vanguard, describes the problem as follows: Imagine you're getting a 7 percent return in the market, and paying 2 percent to do business with your financial advisor. At the end of 50 years, approximately 70 percent of the market returns will have gone to advisors and others, while only 30 percent will have gone to investors. Bogle's example is designed to show his point, because few users of IRAs hold them for 50 years, but still he is right in pointing to the costliness of high wrap fees with investments over multiple years. Regulations that push savers into accounts with wrap fees instead of loads may not be in their best interests.

The key here, however, is getting value for money. Advisors are not going to provide their services for free. High net worth clients can afford to pay for advice but a low-income family does not have a lot of money to put to work even though teaching them about investment options and good investment decisions may be quite time-consuming. We return to this point.

Fraud can also be a problem for retirement savers. Bernie Madoff fooled some very educated and financially literate savers, although in general people in this group are less susceptible to fraud. Education and financial literacy are correlated with income, which means that the poorest suffer the most from problems as they prepare for retirement (Lusardi & Mitchell 2005, Campbell 2006, Gale & Levine 2010).

A fourth important goal is for retirement savers to take advantage of provisions in the tax code that allow them to maximize their retirement returns. Up to a limit, retirement saving can be done on a pre-tax basis with taxes paid upon withdrawal, when tax rates may be lower. This is a good strategy for most moderate or high income households. One concern is that households may decide to withdraw all their accumulated assets at once when they retire, incurring a large tax liability.

The path to achieve retirement goals is therefore four-fold: (1) save enough, and spend sensibly; (2) make sound, age-appropriate investments; (3) avoid fraud and excessive fees; and (4) minimize one's tax liability. While all four objectives are important, in this paper we focus on items (2) and (3), since they are most tied to the DoL's proposed regulation.

Information Failures and Household Saving

In a market economy the first assumption is that households should have the freedom to make their own consumption, saving, and investment decisions. If policymakers are to intervene in the market, they should have good reasons for doing so and policy must be respectful of the rights of individuals. At the same time, it is important to recognize that even though the goals of retirement saving seem relatively simple, the path to achieving those goals is extremely difficult and many people make mistakes. We do not wish to suggest that those who struggle on the path to a secure retirement are unintelligent; on the contrary, we find that low financial literacy and the attendant financial missteps are the result of a lack of information, not a lack of comprehension. Retirement insecurity plagues people of all walks of life. Even experts in this subject make serious savings and investment mistakes sometimes. Saving for retirement is incredibly challenging, particularly when information and resources are limited, and especially when the available information and resources are distributed unequally across various demographic groups. With that caveat in mind, we point to three major issues that make it difficult for savers to adequately prepare for retirement.

1. *A secure retirement requires a lifetime of optimal decisions.* In order to be sufficiently prepared for retirement, most individuals will need to save throughout their entire career. The decumulation phase is generally shorter than the accumulation phase, but it is nonetheless necessary to start making sound savings decisions early in life and to continue the pattern throughout one's working years. The economists' model of behavior assumes rational decision-making over a lifetime even under uncertainty about future income, length of life, health outcomes and other factors. In reality most people struggle to optimize under these conditions and will defer to popular "rules of thumb" or investment advice from friends and family. As a result there is often a serious mismatch between one's savings goals and actual behavior, and a common result is saving too little. This problem of myopia – or shortsightedness – is often exacerbated by the fact that in general our society values immediate consumption over future consumption. Of course, very low-income households may already struggle to meet their day-to-day needs, leaving little or nothing to set aside for use down the road.
2. *Risk management is key*. Most people, even those with high levels of education and experience, find it difficult to manage risk or make good decisions under uncertainty. In particular, it is always tempting to think about an immediate choice as independent from future opportunities and past data (Kahneman & Lovallo 1993). In terms of risk management of a retirement portfolio, some savers may be so risk averse that they sacrifice too much potential return, while others may take on too much risk, convinced they can successfully time the market despite overwhelming evidence to the contrary (Housel 2013, Tuchman 2015). Periods of boom and bust can make this problem worse; booms may generate overconfidence, causing individuals to buy high, and busts may inspire panic, causing them to sell low. These are common mistakes but they have serious long-term consequences.
3. *Compounding can make or break a retirement saving plan.* In general, the earlier one starts saving, the better. This gives an individual the opportunity to spread his or her savings over a long period of time, but it also (and more importantly) allows one to take better advantage of compounding interest (Kiersz 2014).

Many retirement savers are likely to save too little and regret their decisions as they approach retirement and it becomes harder and harder to catch up. They will make mistakes in their investment decisions, not because they are foolish but because investing is hard. Harvard economist Sendhil Mullainathan sums it up neatly in a recent *New York Times* column (July 11, 2015): “Saving more and consuming less is on par with going to the gym more and eating less. Some people can do it easily. Most can’t.” These conclusions tell us that getting good advice in some form is very important for many people.

The Market for Investment Advice

The fact that individuals are not expert in making saving and investment decisions does not in itself mean that there is a market failure. There are many areas where most individuals lack expertise and the most common way to address this deficiency is to seek professional advice and assistance. We typically defer to our doctors, our mechanics, and our lawyers in matters that pertain to our health, our car, and our legal status, rather than attempting to puzzle through the problems ourselves. But while this is an easy solution, it can have complex results. When consumers lack knowledge about where their money is going, problems can ensue. In economists’ terms, in situations where there is incomplete and asymmetric information, markets may fail or may not perform well.

Economic incentives act as a powerful motivation that may influence decisions by honest and trained professionals. Professional norms are shifted by economic factors and then individuals simply follow their colleagues’ examples. Pitfalls arise in markets where there is incomplete information and this general problem is especially relevant to the world of investment advice, which can have dramatic effects on an individual’s future. We consider how professional advice can impact positively or negatively the investment decisions of small and moderate savers by revisiting the four goals addressed above.

Saving Enough (and Spending Sensibly). Many young people start retirement saving through a company 401(k) plan where they are asked to contribute from their salaries to a fund that usually offers several investment choices. In large part because of the efforts of behavioral economists, it is now common for 401(k) plans to automatically enroll workers in a retirement plan.[2] (Workers can opt-out of the plan if they wish.). By changing the default status from "unenrolled" to "enrolled," employers nudge their workers into saving for retirement.[3] Some employers also make contributions to a retirement plan for all employees (usually with a vesting requirement) and others offer matching plans where an employer will match the employee contribution up to a limit. Up to a limit, contributions can be made pre-tax.

Other households start saving through an IRA or rollover into an IRA when they change jobs. In these cases, a financial advisor has a clear incentive to encourage the client to save more and build up the account. Advisors are compensated either on the basis of a fee at the time the investment is made (a "load fee") or from receiving a percentage of the assets (a wrap fee). The more a client saves, the more his or her advisor earns. Advisors generally encourage their clients to set up a systematic saving plan and add to their retirement assets over time. Evidence is consistent with the view that IRA savers with advice save more than those without it. According to Limra (2012), 78 percent of workers who have a financial advisor also contribute to a retirement plan, compared to 43 percent of workers without an advisor. This is an important contribution from professional advisors. (It is possible that those workers who seek out professional advice are already more likely to save for retirement, perhaps because of their education level, earnings, or other variables. Individuals who choose to work with financial advisors may self-select.)

How much should households save? That is too complex to summarize easily and is the subject of a wide literature, but a simple illustration is helpful. A rule of thumb provided by advisors is that households that withdraw 4 to 5 percent of their assets each year will avoid running out of money. That would mean that each $100,000 of assets held at retirement will yield an income of $4,000 to $5,000 a year—not very much. To enjoy a retirement income on par with the median U.S. household income ($51,939), one would need to accumulate assets of between approximately $1.04 and $1.3 million, well

[2] See RSP (2006a, 2006b).
[3] See Thaler & Sunstein (2008).

above the typical retirement portfolio (Census Bureau 2014). Assuming one also receives average Social Security benefits (about $15,500 per year), the necessary assets would be reduced to between $730,000 and $912,000 (SSA 2015). While this is a more achievable goal, it is still significantly more than most people are able to save.

Portfolio Choice: Real estate, Stocks, Bonds, and Savings Accounts

For ordinary savers there are effectively four ways in which they save for retirement: real estate, stocks or equities, bonds, and savings accounts. Making a wise portfolio choice among these options is an extremely important one and the success of a retirement portfolio depends heavily on what choices are made.

Real Estate. The real estate option for most households takes the form of buying an owner-occupied house, or perhaps a second home. Until the real estate bubble burst in the financial crisis many families believed that owning a home was the best investment they could make, and one of the safest as housing prices had never declined on a sustained, nationwide basis in the postwar period. For many people owning a home was in fact their best investment. US tax law provides a substantial incentive to borrow against a home because it allows mortgage interest and property taxes to be included in itemized deductions, up to a limit. Upper income taxpayers are able to gain a sizable benefit from these provisions. Owning a home and paying off the mortgage over 30 years also gave a way of saving simply by paying the mortgage. Households that retired with their mortgage paid off could live without paying rent, and often had several hundred thousand dollars in equity in their homes that could be realized by selling the home or borrowing against the value for retirement living expenses if needed.

The value of housing as a form of retirement saving was undermined by the housing bubble. As prices escalated there was temptation to use the rising equity value as collateral for buying autos or funding college costs. Once prices fell, many households ended up with diminished equity or even found they were underwater. Nevertheless, homeownership still remains a potent instrument for retirement saving. Given the tax advantages and the "nudge" it provides for saving, homeownership will continue to be a valuable retirement tool. Home prices are now moving up and are likely to keep pace with inflation.

Stocks and Bonds. The standard advice to those investing in financial assets for retirement is that they hold a diversified portfolio of stocks and bonds. Younger savers are encouraged to have a larger share of their portfolio in stocks, with the share of bonds rising with the age of the saver in order to reduce risk. We do not wish to question the underlying logic of this view, but it is worthwhile reviewing the findings in the economics and finance literature about the relative returns of the two classes of assets.

In a classic article in 1985 Rajnish Mehra and Edward C. Prescott pointed out that, based on historical data, equity returns were much larger than the return on safe bonds and that it requires an extraordinary aversion to risk by investors to justify the "equity premium". In a 2003 article, Mehra revisited the equity premium puzzle and concluded that there remained no convincing explanation of the disparity in returns that is consistent with reasonable levels of risk aversion by investors. Mehra reports that the mean real return on equities from 1947 to 2000 was 8.4 percent a year and the real return on safe bonds was 0.6 percent a year, giving an estimate of the equity premium over this period of 7.8 percent a year.[4] Of course, investment in the stock market is riskier than investing in risk-free bonds, but the disparity of historical returns is so large it seems as if the market is being irrational. As Princeton economist Alan Blinder put it, the only way to explain the equity premium puzzle is if investors have a level of risk aversion that would make it hard for them to get out of bed in the morning.

In a 1991 article, Gregory Mankiw and Stephen Zeldes quantified the level of risk aversion necessary if the historical level of the premium they observed represented the *expected* outperformance of equities over bonds. Investors would have had to prefer a certain payoff of $51,300 to a 50/50 bet paying either $50,000 or $100,000. Jeremy Siegel and Richard Thaler note that $1,000 invested in bonds in 1925

[4] Mehra cites other studies that have found different values for the equity premium, being somewhat lower in other countries and lower in the United States in the 1970s. Equity returns have of course been risky. As Mehra points out, however, bonds can be risky also. Unexpected inflation has greatly eroded bonds values at times and there were defaults of fixed income securities in the financial crisis.

would have been worth $12,720 in 1995, whereas the same $1,000 invested in equities would have been worth $842,000 or 66 times as much.

The reason for the aversion to equities is likely because of episodes very deep price declines, such as the Great Depression; the 1970s (when the decline in the market rivaled the decline in the 1930s after adjusting for inflation) and of course the roller coaster of recent years. The S&P 500 declined from about 1500 in early 2000 to just over 800 in July of 2002. It rose back to a little above 1500 in July of 2007 before falling again to just under 800 in July of 2009; and it has risen above 2100 as this is written in July 2015. People find it hard to understand and manage large risks like these, particularly when they feel they have no control over outcomes. In fact, in an attempt to exert control, many investors panic and exit the market when prices are low and sometimes then buy back in when prices have risen.

What are the implications for retirement savers? One important lesson is that retirement savers are well-advised to hold a significant fraction of their retirement portfolio in a diversified equity fund or an equity index fund. There is risk in this strategy, but the higher expected return justifies the higher risk. A second lesson is that trying to time the ups and downs of the market is a mistake and a way of losing money. A buy and hold strategy is the right one, not because the risk of equities goes away over time, it does not, but because holding equities over a long period takes advantage of the compounding of higher returns to offset the effect of the short run gyrations of the market.

Savings Accounts. According to computations by the McKinsey Global Institute (2013, Exhibit 15) using Flow of Funds data, in 2012 Americans held around $8.7 trillion in currency and deposits which are currently earning zero or tiny interest returns and negative real returns. One cannot say that all Americans hold too much in their bank accounts because many or even most Americans report they could not easily come up with even small amounts to cover an emergency funding need. Many households live from paycheck to paycheck. Still, there are also many households that decide to keep their retirement funds in insured bank deposits or CDs. We understand the desire for safety, but the sacrifice of returns is very high indeed and is likely to mean much less security in a family’s standard of living at the time when they reach retirement.

Retirement Results with Alternative Investment Strategies. In order to provide an indication of potential outcomes from different retirement saving strategies, we present in Tables 1 and 2 the result of a number of alternatives. Throughout, we assume a household with a constant real income of $50,000 a year that chooses to set aside a percent of that income for a retirement fund. Households with higher or lower incomes would have funds at retirement that would be higher or lower in a simple proportion to the amounts shown in the table. We show three alternatives for the percent of income placed into the fund, assuming the contributions are made automatically every month. The savings then accumulate over time at a rate of return that varies by type of investment. The first alternative shown is based on the recommendation of the White House under MyRA, which is to invest in Treasury securities. Based on an analysis in the Wall Street Journal of January 29, 2014 the Thrift Savings plan option that invests in Treasuries has earned 3.61 percent a year between 2003 and 2012. We assume that this return is continued into the future and that inflation is 2 percent a year giving a real rate of return of 1.61 percent a year. The second option assumes that the saver divides her or his funds between a stock fund (an index fund for example) and a bond fund. Based on the findings shown earlier in this paper, we assume that this mixed portfolio earns a 4 percent real return. The third option shows the result of investing in all equities, in an index fund that earns a 6 percent real return (an optimistic view of returns going forward). The next two columns basically repeat the previous two columns but under the assumption that the saver pays a 1 percent a year wrap fee that reduces returns correspondingly. Table 1 shows accumulations after 15 years and Table 2 shows accumulations after 30 years. Note that all results adjust for 2 percent inflation.

The results show that it is hard for a middle income saver to reach the retirement goals that households say they want. A saver that invests 5 percent of their income for 15 years in the very safe option of MyRA would have $42,345 at retirement, which would provide an income supplement of $1,693 to $2,117 a year, not a whole lot. Saving 15 percent of income for 30 years in MyRA results in an accumulation of $288,461which would yield $11,538 to $14,423 a year in retirement. This amount would be an important supplement to Social Security but is not a huge sum given such industrious saving for 30 years.

All the other figures in the tables show larger accumulations than MyRA, although there is greater risk associated with these alternative options. There are many numbers in the tables but to pick an example at the other end of the risk spectrum, consider someone placing 10 percent of income in an index stock fund for 30 years. This generates $406,047 at retirement that in turn would provide an annual income supplement of $16,242 to $20,302 per year. If a one percent fee is deducted, the accumulation and resulting retirement income are about 16 percent lower.

To give a sense of the risks involved consider first the 15 year saver. If the equity market were to be depressed and be 30 percent or more below its assumed trend growth rate, then the accumulation from the index stock fund would be below the amount from MyRA. For the 30 year saver, the equity market would have to be over 50 percent below its assumed trend growth rate before the safer option wins out. The S&P index fell by nearly 50 percent during the Great Recession, but recovered strongly afterwards.

Most retirement advisors recommend that young savers take more risk and then reduce risk as they near retirement. This approach makes sense, and individuals can decide how much risk they want to take. Relative to the alternatives described here, this might mean holding an all equity portfolio for a period of years and then gradually increasing the share of bonds. Most advisory firms have target funds that automatically adjust the portfolio for the age of the investor.

Table 1. Saving achieved over 15 years for $50,000 per year income earner based on various investing options (real $)

					Fund with 1 percent wrap fees	
	Type of investment	**MyRA**	**Mixed Stock and Bond Fund**	**Index Stock Fund**	**Mixed Stock and Bond Fund**	**Index Stock Fund**
	Risk level	Very Low	Moderate	High	Moderate	High
Percent of	5%	42,345	50,970	59,773	47,133	55,172
income saved	10%	84,690	101,940	119,547	94,266	110,344
each month	15%	127,035	152,911	179,320	141,400	165,515

Table 2. Saving achieved over 30 years for $50,000 per year income earner based on various investing options (real $)

					Fund with 1 percent wrap fees	
	Type of investment	**MyRA**	**Mixed Stock and Bond Fund**	**Index Stock Fund**	**Mixed Stock and Bond Fund**	**Index Stock Fund**
	Risk level	Low	Low to Moderate	High	Low to Moderate	High
Percent of	5%	96,154	142,765	203,024	120,565	169,870
income saved	10%	192,307	285,529	406,047	241,130	339,740
each month	15%	288,461	428,294	609,071	361,696	509,610

What Should Advisors be Doing?

We have established that investing is difficult, and most consumers lack the expertise to make sound investment choices on their own. Even semi-savvy savers who understand the principles of diversification, buy-and-hold, and de-risking may struggle to optimize. Therefore professional advisors can provide an important service to savers by helping them allocate their portfolios in the best possible way. At the same time receiving investment advice can be costly, not surprisingly if a professional has to spend several hours talking with a client and handling the portfolio and changes over time.

How valuable or costly is advice? The answer is hard to determine. Vanguard (2014) finds that net returns increase by approximately 3 percent when investors work with an advisor and follow Vanguard's Alpha framework for wealth management. Earning an extra 3 percent on retirement funds is an enormous difference. The alternative view is that advisors actually yield lower returns on net. For example, Hackethal et al. (2012) find that professional advisors are actually associated with more risk, lower returns, and higher trading frequency. Foerster et al. (2014) suggest that advisors fail to "add value through their investment recommendations when judged relative to passive investment benchmarks." Chalmers & Reuter (2013) find that clients of financial advisors have riskier portfolios than other individuals, and that their accounts tend to underperform. As is so often the case with economic evidence, the results are all over the place.

Positive contributions that advisors can make.

1. Advisors can provide information about how much should be saved to achieve a given retirement goal.
2. Advisors with good firms can help savers avoid obvious pitfalls, such as fraudulent investments or panicking and taking money out during periods of market turmoil.
3. Advisors can help savers choose the right level of risk so that they can benefit from the higher returns available in equities with a properly diversified fund. They can discourage market timing efforts.

4. Advisors can help broaden the choice savers have available, such as overseas investment funds that may add returns and reduce risks.
5. Advisors can assist savers as they retire and start to withdraw money.
6. Advisors can assist savers with minimizing their tax liability. Most Americans fail to optimize their own tax burden by overlooking potential deductions, choosing not to itemize, and making errors.

Concerns about actions that may be harmful to consumers.

1. To the extent that advisors are compensated by the funds they choose, they will have an incentive to pick funds that increase their own rewards.
2. The nature and amount of fees received by advisors are often not transparent and may not be appreciated by the client.
3. It may be difficult or impossible for small savers to obtain the level of advice they need in an economical way. While there is a reasonable concern about excessive fees that have been charged by some advisors, it also likely that helping small savers has long been a losing proposition financially for advisors. In some cases investment advice is offered essentially as a loss-leader for other services being provided, such as insurance. Furthermore, the share of low-income households who use a financial planner is already significantly lower than the share of high-income households who do. According to GAO (2011), nearly 40 percent of top-income-quartile households use a professional advisor for saving and investment decisions, compared to only 10 percent of bottom-income-quartile households. Most small-scale savers are already forgoing professional advice.

Implications for the DoL's proposed conflicted interest rule

There is not an effective infrastructure for advising small savers on the right strategy for them to replace the defined benefit plans that are rapidly disappearing. In the days of defined benefit plans, the investment advice was built into the plan and workers did not need to use advisors, but now they do.

Many people would like to go back to the old days of company pension plans but that is not going to happen.

The lowest percentiles of the income distribution are probably not in the market for investment advice and will continue to rely on Social Security, Medicare and part-time work for support as they age. Preserving Social Security with adequate benefit levels for low-income households is a top priority.

Households at the next level up would like to save modestly to supplement to Social Security and other income but their options for advice are limited. It is difficult for the private sector to provide tailored advice to individual households at moderate income levels and make a return that is adequate for the resources needed. The Administration has argued that online advice may be the way to go for these savers, and for some fraction of this group that may be a good alternative. Relying on online sites to solve the problem seems farfetched, however. Maybe at some time in the future that will be a viable option but at present there are many people, especially in the older generation, who lack sufficient knowledge and experience to rely on web solutions. The web offers dangers as well as solutions, given the potential for sub-optimal or fraudulent advice. Another suggestion by the Administration is that small savers use MyRA as a guide to their decisions and this option is low cost and safe, but the returns are very low and will not provide much of a cushion in retirement unless low income households set aside a much larger share of their income than has been the case historically.

We are conducting a social experiment in which we expect more and more people to figure out how finance their own pensions when there is no indication that they have the requisite knowledge nor is there a known viable business model to provide the kind of advice they need. We applaud the DoL's efforts to ensure that advisors act in the best interests of their clients, but we also urge the DoL to avoid shutting low- and moderate-income savers out of the advice marketplace. This is currently a problem and we judge that the retirement predicament facing many Americans could worsen if these groups remain unable to reliably access good information and advice.

Upper income households are also in need of good advice and benefit from clear and transparent standards for investment advisors. For this group, greater disclosure can be very helpful, letting clients know how their advisors are being compensated and how their compensation may be impacted by different investment choices being recommended.

We believe that it is appropriate for the Administration to look at investment advisors and to see if there are behaviors that are harmful to consumers that require regulatory action. We also believe that new rules should be simple and workable and should make sure there is full disclosure that is understandable.

Implications for small-scale savers. The proposed rule will bring with it increased compliance costs. These costs, combined with a reluctance to assume more risk and a fear of litigation, may make some advisors less likely to offer retirement advice to households with modest savings. These households are the ones most in need of direction and education, but because their accounts will not turn profits for advisors, they may be abandoned. According to the Employee Benefits Security Administration (EBSA), the proposed rule will save families with IRAs more than $40 billion over the next decade. However, this benefit must be weighed against the attendant costs of implementing the rule. It is possible that the rule will leave low- and medium-income households without professional guidance, further widening the retirement savings gap. The Department of Labor should consider ways to minimize or manage these costs. Options include incentivizing advisors to continue guiding small-scale savers, perhaps through the tax code, and promoting increased financial literacy training for households with modest savings.

Clarifications about education versus advice. The proposed rule distinguished education from advisement. An advisor can share general information on best practices in retirement planning, including making age-appropriate asset allocations and determining the ideal age at which to retire, without triggering fiduciary responsibility. This is certainly a useful distinction. However, some advisors could frame this general information in a way that encourages clients to make decisions that are not in their own best interest. We encourage the Department of Labor to think carefully about the line between education and advice, and how to discourage advisors from sharing information in a way that leads to future conflicts of interest. One option may be standardizing the general information that may be provided without triggering fiduciary responsibility.

Implications for risk management. Under the proposed rule advisors may be reluctant to assume additional risk and worry about litigation. In addition to pushing small-scale savers out of the market, we also worry that the rule may encourage excessive risk aversion in some advisors. General wisdom suggests that young savers should have relatively high-risk portfolios, de-risking as they age, and ending with a relatively low-risk portfolio at the end of the accumulation period. The proposed rule could cause advisors to discourage clients from taking on risk, even when the risk is generally appropriate and the investor has healthy expectations. Extreme risk aversion could decrease both market returns for investors and the "value-add" of professional advisors. We ask that the Department of Labor think carefully about how it can discourage conflicted advice without encouraging overzealous risk reductions.

The proposed rule is an important effort to increase consumer protection and retirement security. However, in its current form, it may open the door to some undesirable or problematic outcomes. With some thoughtful revisions, we believe the rule can provide a net benefit to the country.

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