Economic
Policy
Institute

August 6, 2020

Office of Exemption Determinations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Ave., N.W.
Suite 400
Washington, D.C. 20210

Re: Application No. D-12011
Improving Investment Advice for Workers & Retirees

To whom it may concern:

The Economic Policy Institute (EPI) is a nonprofit, nonpartisan think tank created in 1986 to include the needs of low- and middle-income workers in economic policy discussions.

EPI and other organizations representing workers, consumers, investors, and retirees submitted a joint letter opposing the Department of Labor's proposed new retirement advice rulemaking package. EPI is submitting a separate letter to elaborate on some of the points made in the joint letter.

In the joint letter, EPI and the other co-signers objected to the department's final rule reinstating the 1975 regulatory definition of fiduciary investment advice and the department's proposed exemption allowing investment advice fiduciaries to earn conflicted compensation when providing advice regarding retirement account investments.

With respect to reinstating the old definition of fiduciary advice, the joint letter points out that the five-part test excludes most of the conflicted "advice" retirement savers receive, since only advice provided on a regular basis, not offered under the guise of investor education, and intended to serve as a primary basis for the retirement saver's investment decision is considered fiduciary advice. This narrow definition allows financial professionals to disguise sales pitches tainted by conflicts of interest as disinterested advice, notably when encouraging 401(k) account holders to roll over their balances into higher-cost investments, including opaque and illiquid investments not regulated by the Securities and Exchange Commission (SEC).

Opening the door wider to conflicts of interest, the department is also proposing a new exemption to the prohibited transaction provisions under the Employee Retirement Income Security Act of 1974 (ERISA), allowing fiduciaries who provide advice on retirement investments to receive compensation that creates a conflict of interest. The proposed prohibited transaction exemption, which only requires that an effort be made to mitigate the conflict, is modeled on the SEC's vague Regulation Best Interest ("Reg. BI"). It broadens ERISA's exemption from fiduciary status to include professionals providing "advice" on annuities and other investment products not considered securities and therefore not subject to SEC rules.

As EPI and others noted when the SEC proposed Reg. BI, nothing in that regulation requires financial professionals to act in investors' best interest. Rather, the "best interest" standard appears indistinguishable from the Financial Industry Regulatory Authority's (FINRA's) "suitability" standard, which only prohibits financial professionals from steering investors to egregiously unsuitable products, such as recommending highly risky investments to risk-averse clients. It does not prevent broker-dealers and others from promoting higher-cost but "suitable" investments when similar or better lower-cost investments are available.

The department claims that reinstating the old fiduciary definition and proposing a new prohibited transaction exemption is intended to improve investment advice and options for workers and retirees. This is not supported by the evidence. As we discuss at greater length in our comment on the SEC's proposed Reg. BI, the industry lobby—despite the considerable resources at its disposal—has failed to show that conflicted "advice" is, on net, valuable to investors. However, the SEC and DOL appear to accept this at face value.

Prohibiting conflicted transactions does not entail a societal cost, even if there are costs to some professionals and firms, if these transactions involve rent-seeking as opposed to wealth-generating behavior. From our letter to the SEC:

> Conflicts of interest between buyers and sellers are commonplace. Many salesmen, including brokers and car dealers, are paid on commission. However, it has long been recognized that markets for professional advice are different from markets for automobiles because information asymmetries are inherent in these transactions.
>
> For this reason, markets for professional advice are highly regulated and often impose an affirmative duty on professionals to act in their clients' interest, while specifically prohibiting transactions that involve conflicts of interest. For example, doctors operating under a duty of care to patients cannot be compensated by pharmaceutical companies for prescribing specific medications. These regulations are imperfect, however. In most states, doctors may be wined and dined by pharmaceutical companies and offered other inducements, as long as these are not contingent on prescribing medications.
>
> It is currently legal for some financial professionals, notably broker-dealers, to present themselves as disinterested advisers while recommending products or services that are clearly worse for investors but

more lucrative for sellers than available alternatives. When broker-dealers present themselves as "advisers" in order to sell investment products and services for which they receive commissions, it is as if pharmaceutical representatives were not just influencing doctors and patients through gifts and advertisements, but selling drugs directly to patients while presenting themselves as healthcare professionals…

[In] combatting the DOL's fiduciary rule, industry focused on evidence that the rule would limit the range of products and services offered to retirement savers, including incidental "advice" offered to clients by broker-dealers.[1] The short-lived DOL rule did affect the mix of products and services marketed to investors, accelerating a flight from high-fee products and broker-dealer services in favor of lower-cost products and unbiased advice from fiduciary advisers and "robo-advisers" among others.[2]

It is not clear whether the rule resulted in fewer choices for investors, rather than different choices. In any case, the SEC appears to have accepted the industry argument that more choice is inherently better, ignoring evidence that choice overload can hinder decision making. This is especially true in retirement savings decisions and other contexts in which decision-making is difficult due to complexity and asymmetric information.[3]

Admittedly, the government is not generally in the business of limiting consumer choice for its own sake, even if this might make many consumers better off.[4] However, if limiting conflicted investment advice indirectly results in better but possibly fewer investment options, this is a desired outcome, not a valid argument against such limits. Simply put, we should not mourn the loss of products and services that are only competitive if recommended by conflicted advisers…

A regulation that corrects a market failure—in this case, an information asymmetry between financial professionals and unsophisticated investors—is, by design, costly to businesses that thrive on taking

[1] See, for example, U.S. Chamber of Commerce, "Fiduciary Rule: Initial Impact Analysis," September 7, 2017.

[2] Brian Menickela, "The DOL Rule – It Was The Best Of Times, It Was The Worst Of Times," *Forbes*, August 21, 2017.

[3] Sheena Sethi-Iyengar, Gur Huberman, and Wei Jiang, "How Much Choice is Too Much? Contributions to 401(k) Retirement Plans," in Olivia S. Mitchell and Stephen P. Utkus (Eds.) *Pension Design and Structure; New Lessons from Behavioral Finance*, Oxford University Press, 2015; Shlomo Benartzi and Richard H. Thaler, "Heuristics and Biases in Retirement Savings Behavior," *Journal of Economic Perspectives*, Volume 21, Number 3, Summer 2007, Pages 81–104; Shlomo Benartzi and Richard H. Thaler, "Naive Diversification Strategies in Defined Contribution Saving Plans," *American Economic Review*, Vol. 91, No. 1, March 2001, pp. 79-98.

[4] Barry Schwarz, *The Paradox of Choice; Why More is Less*, New York: HarperCollins, 2004.

advantage of the market failure. The cost to these businesses is not, however, a societal cost, except to the extent that compliance is costly for all businesses and these costs are passed on to consumers. Only in this case must the costs to businesses be weighed against the benefits to consumers. Otherwise, one firm's loss is another's gain, and society clearly benefits from correcting the market failure…

[Much] of the "advice" provided by broker-dealers not only lacks value, but is actually harmful, steering savers to higher-cost products and costly services that will reduce their future standard of living compared to how they would fare in the absence of this "advice." This may be true whether or not, in the absence of conflicted "advice," investors would have availed themselves of more paid or free advice from more impartial sources…

[It] is unlikely that broker-dealer commissions actually pay for useful advice. Most of the advice retirement savers and other small investors benefit from is generic, and the marginal cost of disseminating it is negligible. The fact that generic advice resembles a public good suggests that it should be—and is—provided by government agencies and nonprofit organizations. However, since appraising and absorbing such information can be difficult and time consuming, bad information from conflicted advisers can be worse than superfluous, it can be harmful to small investors, making them less likely to avail themselves of useful advice.

To the extent that small investors could actually use one-on-one advice, it is often to counter misinformation from conflicted advisers. Beyond that, financial technology is making it easier to provide low-cost investment advice tailored to individuals' risk preferences. Meanwhile, advice from unbiased sources is available free or at low cost from library books, newspapers, and online—including from the SEC itself. This is all that many investors need, given the ready availability of low-cost, broadly-diversified, mutual funds.

Some investors, of course, do benefit from advice tailored to their specific needs. But there is no reason to believe that this advice will be more affordable if paid for indirectly through broker-dealer commissions. Hiring a fiduciary adviser may cost more up front than paying broker-dealer commissions, but the advice received is of better quality. In reality, the value of broker-dealer "advice" is likely to be negative…

[The] relevant question is not whether consumers lose access to certain products and services currently being offered. After all, if the goal is to restrict "advice" steering savers to poor investments, any effective regulation will reduce conflicted "advice" and make overpriced or lower-quality products less competitive. Rather, the question is whether consumers gain or lose from changes in products and services resulting from regulation, including newly available products and services and impartial advice that was previously buried under misinformation.

It is undoubtedly true that with effective regulation consumers will be offered less bad advice and fewer unnecessarily expensive products and services, and that companies and individuals engaged in such practices will be negatively affected, though other financial actors stand to gain. This is the purpose of the regulation, after all.

Does anyone truly believe that conflicted advisers help resolve information problems, rather than contributing to them? We are inclined to agree with authors Helaine Olen and Harold Pollack that everything most people need to know about personal finance can fit on an index card—unless, that is, they have been misled by conflicted advisers.[5] One of the authors' nine index card tips was to seek financial advice only from professionals held to a fiduciary standard.

The financial industry lobby failed to credibly demonstrate that there was a societal cost to the DOL rule, as opposed to a cost to some financial professionals and firms. Government regulators should not be in the business of protecting industry profits if these come at the expense of consumers. Industry groups failed to even clear a lower bar—demonstrating that a significant number of consumers would be hurt, even if most benefited.

Critics of regulation often say government should not be in the business of picking winners and losers. However, the same may be said of a failure to act if the playing field is not level. The government is, in effect, enabling bad actors at the expense of those who provide unbiased advice and sell products that are in clients' true best interest…

The industry never bothered to explain why affordable "advice" can only be provided by conflicted professionals acting in the guise of disinterested experts to clients often unaware that they are paying for this supposed service…

Effective regulation—in whatever form it takes—should reduce the biased "advice" received by consumers and make the market for investment products and services more competitive. This in turn should crowd out higher-cost and lower-quality products and services, while expanding opportunities for businesses offering better options. Whether or not consumers are left with fewer choices, they will benefit from better ones.

[5] Helaine Olen and Harold Pollack, *The Index Card: Why Personal Finance Doesn't Have To Be Complicated*, New York: Penguin Random House, 2017.

Our full letter to the SEC is available here: https://www.epi.org/publication/epi-comments-regarding-regulation-best-interest/

In short, the old definition of fiduciary advice that the department is attempting to restore is so narrow as to allow virtually all the abuses that the department's fiduciary rule, which this administration has abandoned, was intended to address. The SEC's Reg. BI is equally toothless and should not serve as a model for the department.

Respectfully,

Monique Morrissey
Economist, EPI

Heidi Shierholz
Senior Economist and Director of Policy, EPI