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EPI comment on the proposal to extend the applicability date to the fiduciary rule

Testimony • By Heidi Shierholz • March 17, 2017

Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue NW
Washington, D.C. 20210

Attention: Fiduciary Rule Examination, RIN 1210-AB79

To the Department of Labor:

We are writing to express our strong support for the scheduled April 10, 2017, applicability date of the Department of Labor's fiduciary rule. We are opposed to any delay. As the department notes, retirement savers and other investors would be harmed by the delay, while the financial industry would benefit. Crucially, the costs to savers of a delay far outweigh any benefits to the financial industry. The department should conclude that the delay is unjustified.

Most savers do not know that it is currently legal in many cases for financial professionals to recommend higher-cost investment products that provide financial advisers with a higher commission but provide lower returns to advisers' clients. Most people do not understand that, unlike lawyers and doctors, all financial advisers are not required to act in their clients' best interests. The fiduciary rule would require that financial advisers provide retirement investment advice that is in the best interest of their clients. People who have worked hard to save for retirement need and deserve these common sense protections—protections that most people are shocked to discover aren't already in place.

The proposal to delay these important protections is simply unjustified.

The regulatory impact analysis (RIA) of the proposed delay utterly fails to establish that the benefits of delay outweigh the costs. The RIA acknowledges that the delay could lead to losses for retirement investors who follow affected recommendations. The RIA estimates that those losses could amount to $147 million in the first year and $890 million over 10 years using a three percent discount rate, with an equivalent annualized loss of $104 million. However, the estimates of these losses miss important effects and necessarily lead the RIA to underestimate the losses. The RIA notes that the estimate is incomplete because, among other reasons, "it represents only one negative effect (poor mutual fund selection) of one source of conflict (load sharing), in one market segment (IRA investments in front-load mutual funds). Not included are additional potential negative effects of the proposed delay that would be associated with other sources of potential conflict." For example, in addition to IRAs, the fiduciary rule also applies to 401(k)s, and the impact of delaying the rule in that nearly $5 trillion market segment is not taken into account in the department's estimates.

The RIA notes that the losses to retirement investors would "continue to accrue until affected investors withdraw affected funds or reinvest them pursuant to new recommendations" and that losses up to that point "would not be recovered, and would continue to compound, as the accumulated losses would have reduced the asset base that is available later for reinvestment or spending." In other words, if there is a delay, losses to retirement investors will persist and compound long after the delay ends. This provides a powerful incentive to financial firms to use a delay period to recommend investment products with long surrender periods and high surrender fees. This means that the current measures of underperformance of conflicted funds may understate the underperformance during a delay, and thus the cost to retirement investors of a delay may be even further underestimated.

Additionally, the RIA does not even attempt to make the case that the potential reduction in compliance costs or any other industry costs associated with the delay offset the enormous costs to investors. Indeed, such a comparison would lead to the conclusion that the losses to investors far outweigh the reduction in compliance costs. The only estimate in the RIA of cost reduction to businesses is a $42 million reduction in day-to-day compliance burdens during the 60-day delay; an equivalent annualized value is $8 million using a three percent discount rate. This amounts to just 7.6 percent of the RIA's estimated annualized potential losses to retirement investors as a result of the delay, $104 million.

Further, while acknowledging substantial uncertainty in its quantitative estimates, the RIA nevertheless fails to make any qualitative case that benefits to the industry meet or exceed losses on the part of retirement investors. The department simply does not provide anywhere near enough information for it to conclude that the benefits of the proposed delay justify its costs to retirement investors. It would be arbitrary and capricious to move forward with the delay using only the information available in the RIA. On the other hand, if the department receives a great deal of additional information during the comment period upon which it believes it could potentially base a decision that the benefits of delay outweigh the costs to retirement investors, it would be required to issue another notice of proposed rulemaking (NPRM) with a complete RIA incorporating the new information that the public could comment on.

We have constructed an estimate of the reduction in gains to retirement investors as a result of the delay that takes into account not just front-load mutual funds, as the RIA estimate does, but also other types of load mutual funds and variable annuities held in IRAs. It should be noted, however, that our estimate is still a substantial underestimate because it leaves out all the other sources of potential conflict (for example, like the department's estimate, our estimate does not take into account 401(k)s). A detailed methodology for our estimate is attached. A benefit of our methodology is that it allows us to calculate the cost of a delay of any length, not just 60 days. The 60-day number in the NPRM appears to be pulled out of thin air, which is in itself arbitrary and capricious. An analysis should be based on the reasonably anticipated length of delay, not an arbitrary period.

We estimate that every seven days that the fiduciary rule's applicability is delayed would cost retirement savers $431 million over the next 30 years. Thus, the costs of a 60-day delay to retirement savers is $3.7 billion, and each additional 30-day delay will add $1.85 billion to that estimate. Given the large, persistent losses to retirement investors of even a weeklong delay, we oppose a delay of any length of the applicability date of the fiduciary rule.

Retirement investors need and deserve to receive the protections of the fiduciary rule without delay. The department should conclude that the proposed delay is unjustified and that the fiduciary rule should become applicable on April 10, 2017, as scheduled.

Sincerely,

Heidi Shierholz

Director of Policy at the Economic Policy Institute, and former Chief Economist at the Department of Labor

Addendum: Methodology for estimating the losses to retirement investors of fiduciary rule delay