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EPI comments on DOL's Retirement Security Rule — Definition of an Investment Advice Fiduciary

Public Comments • By Monique Morrissey and Heidi Shierholz • January 2, 2024

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January 2, 2023

Lisa M. Gomez
Assistant Secretary for Employee Benefits Security
Office of Regulations and Interpretations
Employee Benefit Security Administration
U.S. Department of Labor
200 Constitution Ave. NW
Washington, DC 20210

Re: RIN 1210-AC02 Retirement Security Rule: Definition of an Investment Advice Fiduciary and related exemptions

Dear Assistant Secretary Gomez:

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 conducts research and analysis on the economic status of working America, proposes public policies that protect and improve the economic conditions of low- and middle-income workers, and assesses policies with respect to how well they further those goals.

EPI strongly supports the Department of Labor's (DOL) Retirement Security Proposal, which would strengthen protections for retirement investors who seek professional investment advice. As outlined in a coalition letter that EPI also signed, the Department's proposed rule would ensure that all investment professionals provide advice that is in retirement investors' best interest and that any conflicts of interest do not taint their advice.

The DOL proposal would close regulatory loopholes, ensuring that key protections for retirement savers cover the following: one-time advice, including advice on rollovers from employer plans to Individual Retirement Accounts (IRAs); advice to employers who sponsor plans; and advice on all retirement investments, including insurance products and other non-securities.

We urge the Department to finalize this proposal without delay.

In this comment letter, we briefly address arguments made by industry lobbyists who claim that the rule would harm retirement savers by restricting access to useful financial advice and would unfairly target certain products, including annuities tied to stock market indices that have been setting sales records.[1]

Industry lobbyists provide no credible evidence to back these claims. For example, Susan K. Neely, the president of the American Council of Life Insurers (ACLI), testified at the DOL Employee Benefits Security Administration hearing on the proposed rule that middle-income Americans stood to lose $140 billion over 10 years and that Black and Hispanic Americans stood to lose 20% of their retirement savings over the same period if the proposed rule were implemented.[2]

The supposed evidence Neely cites to back these claims is a 2021 study by Quantria Strategies, which in turn cites a 2019 Vanguard study by Kinniry Jr. et. al. that estimates that Vanguard's Personal Advisor Services could add 3 percent to annual net returns.[3] However, Vanguard advisors are fiduciaries who do not offer conflicted advice and so would not be affected by the proposed rule! The fact that the insurance industry is grasping at such straws shows that there is no evidence that retirement savers would be harmed if insurance companies and anyone marketing their products were required to adhere to the same best interest standard that governs the sale of securities.

The insurance industry undoubtedly has reason to oppose the proposed rule, which would curb unscrupulous sales practices that have led to a rapid rise in the sale of expensive, complex, and illiquid annuities to retirement savers. In announcing the proposed rule, President Biden cited the example of annuities with hidden fees marketed to seniors by brokers paid by commission.[4]

President Biden noted that some kinds of annuities may be good options for retirement savers, providing steady and reliable retirement income for life. The proposed rule would not affect the sale of competitively priced annuities recommended by unbiased advisors. It would only prevent salespeople acting as advisors from recommending high-cost annuities that are not in retirement savers' best interest—a practice that persists only because the sale of insurance products is governed by weaker state laws than the federal standard governing the sale of securities.

The president's Council of Economic Advisors (CEA) similarly illustrated the need for the proposed rule by citing the example of Fixed Index Annuities (FIAs).[5] FIA returns are linked to returns on a stock market index, such as the S&P 500, but include a guarantee against nominal losses. In the example cited by CEA, the cost of the guarantee is covered by capping returns above 6.75% (a "cap rate").[6] Based on the cost of a similar guarantee purchased in the derivatives market, the CEA estimated that the sellers would safely net 1.2% annually over the life of the annuity, not counting other fees.

Proponents of FIAs point out that a floor against nominal losses can bring peace of mind to risk-averse investors who might otherwise shy away from investing in the stock market.[7] This may be a valid point, but there are other ways to guard against losses over the long-term, even for small investors who lack access to the derivatives market. Retirement savers can, for example, invest a share of their portfolios in Treasuries or highly rated corporate bonds. While corporate bonds and bond indices are not entirely risk-free, neither are annuities, since an investor must assess whether the insurance company offering the annuity is financially sound enough to meet its obligations in the event of a steep or prolonged stock market downturn. Another option for a risk-averse investor is a traditional income annuity that provides a fixed income for life. These annuities are easier to compare and more competitively priced, though they can be a costly way to guarantee lifetime income when interest rates are low.

This is not to suggest that the main problem with FIAs is risk, or that a fairly priced FIA is always a poor choice for retirement savers (though it is worth noting that risk-averse savers should try to minimize the risk of poor inflation-adjusted outcomes, not set a zero floor on nominal annual returns). The problem, rather, is the high price unsophisticated investors pay to guard against risk when FIAs are not sold in competitive markets.

While FIAs appeal to unsophisticated and risk-averse investors, it is almost impossible for these investors to know if they are getting a good deal, a difficult task even for economists and other financial professionals. Leora Friedberg and Anthony Webb, economists who specialize in retirement and are generally in favor of annuities as retirement vehicles, wrote a "primer" on FIAs and similar variable annuities aimed at other economists who rarely study these investment options because their features are so poorly understood and their complexity makes them difficult to value. For example, Friedberg and Webb note that many of these annuities have optional "guaranteed lifetime withdrawal benefit" riders embedded in their contracts. However, they note that "exercising these options to maximize utility is a complex decision that differs in key respects for different annuity products. We suspect that most households lack the requisite financial skills to make optimal decisions and that they rely on financial professionals instead."[8]

Even if retirement savers avoid optional bells and whistles, the simplest FIA can be difficult to value. Product differentiation across features such as the length of the contract, the cap rate or other interest crediting option, the underlying stock market index, etc., hinder comparison shopping. Even the relatively straightforward FIA described in the CEA blog post gave the seller the right to lower the cap rate in future years despite a penalty for early withdrawal. While the CEA was criticized for singling out a particular annuity provider,[9] they chose an example that was easier to understand than many of the complex products being marketed to small savers.

In their primer, Friedberg and Webb outline a method of valuing these annuities through an optimization model but note the challenges: "The complexity of the optimization problem that we have outlined helps to explain why the academic literature considers simplified versions of annuities. Furthermore, if markets were complete, then investors could simply replicate any potential payout profile using other available assets, obviating the necessity of understanding current annuity products. In our view, however, individual investors lack both the know-how to do this and the access to the same instruments with the same fee structure as insurers have; after all, insurers reportedly devote whole trading floors to hedging and managing VA [variable annuity] risks."

In an August 7, 2018, comment that we submitted to the Securities and Exchange Commission (SEC) regarding Regulation Best Interest, which was cited in the SEC's final rule, we noted that "it has long been recognized that markets for professional advice are different from markets for automobiles because information asymmetries are inherent in these transactions."[10] In other words, if you need to consult a lawyer, doctor, or financial advisor for advice, it is because you do not have the same legal, medical or financial expertise as these professionals. For this reason, professional advice must be carefully regulated to ensure that it is in the best interest of the client.

In that comment, we cautioned against assuming that all financial "advice" offered to clients had value and that more consumer choice was always better. We also warned against conflating costs to certain businesses with costs to consumers and society. Consumer protections, by design, reduce rent-seeking behavior that benefits some businesses at the expense of consumers and more reputable businesses. In other words, bad products and services crowd out good ones.

Financial advisors acting in their clients' best interest may recommend FIAs and similar products to retirement savers, though the size of this market in the absence of conflicted advice remains to be seen. The Retirement Security Rule will ensure that retirement savers are not misled by sales pitches misrepresented as disinterested advice and will expand the market for transparent and competitively priced investments, including annuities. The winners will be retirement savers and companies selling better products.

Respectfully,

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1. Susan K. Neely, "Testimony at the DOL Employee Benefits Security Administration Hearing on

'Retirement Security Rule: Definition of an Investment Advice Fiduciary,'" American Council on Life Insurance, December 12, 2023; Austin R. Ramsey, "Fiduciary 401(k) Proposal a 'Broadside Attack' on Annuity Market," *Bloomberg Law*, November 13, 2023; LIMRA, "U.S. Individual Annuity Sales to Exceed $300 Billion in 2024 and 2025," December 7, 2023.

2. Neely, op. cit. 3-4.

3. Quantria Strategies, *Analysis of the Effects of the 2016 Department of Labor Fiduciary Regulation on Retirement Savings and Estimate of the Effects of Reinstatement*, November 8, 2021; Francis Kinniry, Jr., Colleen M. Jaconnetti, Michael A. DiJoseph, Yan Zibering, and Donald G. Bennyhoff, "Putting a value on your value: Quantifying Vanguard Advisor's Alpha," *Vanguard Research*, February 2019.

4. "Remarks by President Biden on Protecting Americans' Retirement Security," The White House, October 31, 2023.

5. Council of Economic Advisors, "The Retirement Security Rule – Strengthening Protections for Americans Saving for Retirement," CEA Blog, October 31, 2023.

6. There are other ways insurance companies recoup the cost of the guarantee, such as by crediting investors with less than 100% of the index returns (a "participation rate").

7. Wade Pfau, "Longer Terms for Fixed Index Annuity and Why You Should Consider FIAs in

Your Retirement Income Plan," *Forbes,* November 18, 2020.

8. Leora Friedberg and Anthony Webb, "A Primer on Annuities," Retirement Income Institute, July 2022.

9. Jeff Acheson and Brian Graff, "In Defense of Fixed Indexed Annuities," National Association of Plan Advisors, November 7, 2023.

10. Monique Morrissey and Heidi Shierholz, "EPI comment on DOL Bad Advice Rule," August 6, 2020.