Economic Policy Institute

EPI comment on the proposed 18 month delay of key provisions of the fiduciary rule

Public Comments • By Heidi Shierholz • September 11, 2017

Office of Exemption Determinations

Attention: D-11712, 11713, 11850
U.S. Department of Labor
200 Constitution Avenue NW, Suite 400
Washington, D.C. 20210

RE: RIN 1210-AB82

Submitted via: https://www.regulations.gov

To the Department of Labor:

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. We respectfully submit the following comment in response to the Employee Benefits Security Administration's Notice of proposed amendments to PTE 2016-01, PTE 2016-02, and PTE 84-24.

We strongly oppose any further delay in the full implementation and enforcement of the fiduciary rule. In particular, we object to any delay in the January 1, 2018, applicability date of the provisions in the BIC Exemption (PTE 2016-01), Principal Transactions Exemptions (PTE 2016-02), and amendments to PTE 84-24. People who have worked hard to save for retirement need and deserve all of the provisions of the fiduciary rule to be fully implemented and enforced.

The rule has already been delayed. In the second week of his presidency, President Trump directed the department to prepare an analysis concerning the likely impact of the rule—despite the fact that the department had just completed a roughly six-year exhaustive vetting process that produced a nearly 400-page economic analysis on the likely impact of the rule which incorporated feedback from four days of hearings, more than 100 stakeholder meetings, and thousands of public comments. As a result, the entire

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rule was delayed by 60 days—a delay that we estimate will end up costing retirement savers $3.7 billion over the next 30 years. (Note that if there is a delay, losses to retirement investors persist and compound long after the delay ends. The department itself has noted that as a result of a delay, 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.")

Following the 60-day delay, portions of the rule went into effect on June 9, 2017. However, key enforcement provisions were further delayed until January 1, 2018. We estimate the cost to retirement savers of this further nearly seven-month delay of key provisions of the rule will be between $2.0 billion and $5.9 billion dollars over the next 30 years, with a middle estimate of $3.9 billion (please see the attached detailed methodology underlying our estimate).

And now, the department is considering a further delay of 18 months of these valuable provisions. **We estimate the cost to retirement savers of an additional 18 month delay to be between $5.5 and $16.3 billion dollars over the next 30 years, with a middle estimate of $10.9 billion.** Given the large, persistent losses suffered by retirement investors as a result of a further delay of these provisions, we oppose any delay of the full implementation and enforcement of the rule.

Retirement investors need and deserve to receive the protections of the full fiduciary rule. The department should conclude that the fiduciary rule should become fully applicable on January 1, 2018, as currently scheduled.

Sincerely,
Heidi Shierholz
Senior Economist and Director of Policy at the Economic Policy Institute

Addendum: Methodology for estimating losses to retirement investors of partial implementation of fiduciary rule

Economic Policy Institute

Methodology for estimating losses to retirement investors of partial implementation of fiduciary rule

September 11, 2017

The following is the methodology for EPI comments in response to the Department of Labor's (DOL's) Notice of proposed amendments to PTE 2016-01, PTE 2016-02, and PTE 84-24.

EPI estimates that the partial implementation of the fiduciary rule on June 9, 2017, without effective DOL enforcement, will cost workers saving for retirement between $2.0 billion and $5.9 billion dollars over the next 30 years, with a middle estimate of $3.9 billion —assuming the rule is implemented as currently scheduled on January 1, 2018. Delaying DOL enforcement an additional 18 months (from January 1, 2018 to July 1, 2019) would cost retirement savers an additional $5.5 billion to $16.3 billion over 30 years, with a middle estimate of $10.9 billion.

Our methodology and assumptions were adapted from the 2015 report *The Effects of Conflicted Investment Advice on Retirement Savings* by the White House Council of Economic Advisers (CEA) and the April 2017 report *Early Evidence on the Department of Labor Conflict of Interest Rule* by Aron Szapiro and Paul Ellenbogen of Morningstar.

The CEA report focuses only on IRA assets. Their "middle estimate" focuses even more narrowly on load mutual funds and variable annuities held in IRAs. This is the estimate on which we based our earlier estimate of the cost of delaying implementation of the fiduciary rule to June 9, 2017.[1] This was a conservative estimate of the cost of delay because the fiduciary rule also applies to other plans subject to Section 4975 of the Internal Revenue Code, including Keogh plans, as well as 401(k)s and other plans governed by the Employee Retirement Income Security Act. In 2016, there was a total of $4.8 trillion held in 401(k)s alone.[2] Moreover, the assets in retirement plans covered by the fiduciary rule and potentially affected by conflicted advice are not limited to load mutual funds and variable annuities, but also include, for example, fixed annuities. Therefore, the CEA estimate and EPI's estimates consider only a subset of assets potentially affected by the rule.

In addition, EPI's earlier estimate of the cost of delay narrowed the focus to rollovers and not direct contributions to IRAs. EPI's current estimate includes the (much smaller) inflows from direct contributions, but excludes variable annuities in order to take advantage of recent research by Morningstar on the benefit to retirement savers of new mutual fund share classes, such as T shares, created in response to the fiduciary rule. Without effective enforcement, however, mutual fund companies have little incentive to market these lower-cost and higher-performing funds. The Morningstar report finds that "the incentives T shares create to recommend higher-quality funds could add around 50 basis points in returns—30 of which are attributable to manager skill in the form of alpha and 20 of which come from reduced fees—compared to conflicted advice." EPI applies this 50 basis-point difference to projected IRA rollovers and contributions during the current delay in DOL enforcement of the rule (June 9–December 31, 2017) and a potential additional one-year delay (January 1, 2018–December 31, 2018). Our middle estimate uses this 50 basis point difference. This middle estimate is also consistent with 50 percent compliance, given that (as discussed below) the CEA methodology that we base our estimates on assumes, based on a broad review of the literature, that conflicted advice reduces net returns on affected funds by 100 basis points annually.

In 2014, $469.0 billion was contributed or rolled over into Traditional and Roth IRAs.[3] Inflows have been increasing steadily over time; for example, from 2000 to 2014, inflows into traditional IRAs increased by 4.6 percent annually on average. Applying the growth rate of 4.6 percent to IRA inflows, we estimate that at least $529.2 billion will be contributed or rolled over into IRAs in 2017 ($298.6 billion since June 9) and $829.7 billion will be contributed or rolled over in 2018 and the first half of 2019

Following the methodology in the CEA paper, and using updated numbers where available, we assume that 48 percent of IRA assets are invested in mutual funds and 27 percent of these mutual fund assets are invested in load funds. Therefore, we estimate that $37.9 billion in new IRA contributions and rollovers will be invested in high-cost mutual fund shares from June 9, 2017 to December 31, 2017, and $105.4 billion will be invested in high-cost mutual fund shares in 2018 and the first half of 2019.

To estimate the cost to investors, we assume that the amount rolled over to IRAs and invested in high-cost mutual fund share classes is drawn down over 30 years. This is a conservative estimate since it excludes losses by workers contributing directly to IRAs as well as losses associated with other retirement plans. The 30-year horizon is based on the approximate life expectancy of investors and their spouses who roll over funds into IRAs. The average age of these investors is 58.[4] The remaining life expectancy of 58-year-olds is 27.0 years and the life expectancy of the longest-surviving spouse of a 58-year-old couple is 33.7 years.[5] Our 30-year assumption is conservative since it is likely that more than half of savers engaging in rollovers are married and many of them have somewhat younger spouses. Moreover, many IRA investors take only required minimum distributions beginning at age 70 rather than drawing down their savings over their remaining life expectancy, which roughly half of them will outlive. The empirical evidence suggests that the draw-down rate is much lower than we assume in our model.[6] We also assume that rolled-over funds remain in underperforming assets.[7]

In our earlier estimate of the cost of delaying the rule, following the methodology in the CEA paper which was based on a broad review of the literature, we assumed that savers receiving conflicted advice earned returns that were roughly 100 basis points (1 percentage-point) lower each year than they would have been without the conflicted advice. In particular, we assumed that savers who received conflicted advice earned 3 percent per year in real terms, and savers who did not receive conflicted advice earned 4 percent per year in real terms.

For our current middle estimate, we use a more conservative 50-basis-point estimate from Morningstar based narrowly on the difference in net investment returns between A shares sold through brokers and T shares that comply with the new rules. We believe that this underestimates the losses of retirement investors who follow recommendations affected by conflicts of interest, particularly because the maximum front-end sales charge for an A share is 5.75 percent, whereas for a T shares 2.5 percent is typical. Nonetheless, we use Morningstar's more conservative estimate in recognition of the fact that partial implementation, even without DOL enforcement, will have some effect on the investment products being marketed to retirement savers. This middle estimate is also consistent with 50 percent compliance based on the CEA analysis. To generate a range of possibilities, we also calculate losses to retirement savers if the delay of the provisions in question leads to 25 percent compliance (a loss of 75 basis points), and 75 percent compliance (a loss of 25 basis points).

We find that the partial implementation of the fiduciary rule on June 9, 2017, without effective DOL enforcement until January 1, 2018, will cost workers saving for retirement between $2.0 billion and $5.9 billion dollars over the next 30 years, with a middle estimate of $3.9 billion in inflation-adjusted terms. **Delaying DOL enforcement an additional 18 months (from January 1, 2018 to July 1, 2019) would cost retirement savers an additional $5.5 billion to $16.3 billion over 30 years, with a middle estimate of $10.9 billion.**[8]

1. Heidi Shierholz, "EPI Comment on the Proposal to Extend the Applicability Date to the Fiduciary Rule," Economic Policy Institute, March 17, 2017; http://www.epi.org/publication/epi-comment-on-the-proposal-to-extend-the-applicability-date-to-the-fiduciary-rule/, and "Methodology for Estimating the Losses to Retirement Investors of Fiduciary Rule Delay," Economic Policy Institute, March 17, 2017; http://www.epi.org/publication/addendum-methodology-for-estimating-the-losses-to-retirement-investors-of-fiduciary-rule-delay/.

2. Investment Company Institute, *2017 Investment Company Fact Book*, 2017; https://www.ici.org/pdf/2017_factbook.pdf, Figure 7.9.

3. Investment Company Institute, "The US Retirement Market, First Quarter 2017" (https://www.ici.org/info/ret_17_q1_data.xls), Tables 9 and 10.

4. Figure 19 in Craig Copeland, *2014 Update of the EBRI IRA Database: IRA Balances, Contributions, Rollovers, Withdrawals, and Asset Allocation*, Employee Benefit Research Institute Issue Brief, 2016; https://www.ebri.org/pdf/briefspdf/EBRI_IB_424.Aug16.IRAs.pdf. The average age of rollovers is a weighted average, weighted by total rollover amounts by age.

5. Source for individual life expectancy: Internal Revenue Service, "Distributions from Individual Retirement Arrangements," Appendix B, Table 1; https://www.irs.gov/publications/p590b/. Source for joint life expectancy: "Male/Female Joint Life Expectancies Based on Annuity 2000 Mortality Table," https://www.pgcalc.com/pdf/twolife.pdf.

6. According to Figure 27 in Craig Copeland, *2014 Update of the EBRI IRA Database: IRA Balances, Contributions, Rollovers, Withdrawals, and Asset Allocation* (cited earlier), the median withdrawal rate from an IRA is 5.8 percent, not counting those not taking withdrawals, while our method results in an average draw-down rate of close to 15 percent.

7. It is possible that savers will shift toward better-performing funds rather than leaving the same amount in underperforming funds for 30 years—that is, that inertia on the part of savers isn't as strong as we are assuming. However, if we were to take into account reduced inertia in this context, we would also have to revisit our assumption of full inertia vis-à-vis the entire stock of IRA assets held in conflicted accounts. That is, we assume that inertia on the part of savers means that savers who already hold IRA assets for which they received conflicted advice would not be more likely to move their investments into lower-cost funds if the fiduciary rule were fully implemented and enforced without delay. Relaxing the inertia assumption could substantially *increase* our cost estimates.

8. These figures are adjusted for expected inflation over the next 30 years. However, they do not account for the possibility that people may discount future income relative to current income due to the opportunity cost of forgoing investment earnings or for other reasons. If future income is discounted by assumed rates of return, the partial implementation of the fiduciary rule on June 9, 2017, without effective DOL enforcement will cost workers saving for retirement $2.3 billion over the next 30 years. Delaying DOL enforcement through 2018 would cost retirement savers an additional $4.2 billion over 30 years.