Insight

Warren is Wrong about the Fiduciary Rule

MEGHAN MILLOY | FEBRUARY 8, 2017

Yesterday, Senator Elizabeth Warren sent a letter to the Acting Secretary of the Department of Labor (DOL). In it, she contends that the lack of a fiduciary rule is "costing hardworking Americans more than $17 billion each year" and that "a decision to rescind this rule or delay the implementation of this rule in any way would rip billions of dollars in retirement savings from the pockets of hardworking Americans and put it straight into the hands of giant financial institutions." Before this mass hysteria spreads any further, it would be helpful to fact check her arguments.

First, the $17 billion claim: Senator Warren pulled this number directly from the Obama administration's fact sheet intended to promote DOL's fiduciary rule back in April of 2016. In it, his Council of Economic Advisers (CEA) suggests that "$1.7 trillion of IRA assets were invested in products that generally provide payments that generate conflicts of interest." They then suggest, after looking at a handful of decades-old, non-asset-weighted studies, that conflicted advice lowers annual returns by 1 percent. So, by taking 1 percent off across the board, their $17 billion loss estimate was born.

It's not clear how CEA found that $1.7 trillion of IRA assets presented a conflict of interest, but some facts about IRAs and the potential costs of the fiduciary rule are very clear. According to the Census Bureau, there were 115.6 million American households in 2013. Of those households, 49.2 percent had a retirement account. That leaves us with 56.9 million retirement accounts containing assets totaling $7.3 trillion. Of that $7.3 trillion, 86.2 percent is in a commission- or transactional-based account, meaning that, instead of paying high fees directly to the advisor, the adviser is taking a smaller fee that is a portion of the earnings on the account, which also incentivizes the adviser to help the account earn higher returns. That translates to roughly $6.3 trillion in commission- or transactional-based accounts on which a fee has already been paid. If the fiduciary rule does become effective in April, each of those accounts will be moved to a fee-based account and will be forced to pay an adviser fee on top of the commission they've already paid. And that's assuming their accounts won't be closed entirely for lack of a viable minimum balance – more on that later.

Even with a fee of just 1.2 percent, that's $75.6 billion in additional, duplicative fees on American retirement accounts, or average extra charges of $1500 per household account – a far cry from the $17 billion in savings. Not to mention that the lower the account balance, the higher the fee, and vice versa. So, with 91 percent of retirement accounts containing less than $250,000, chances are the average adviser fee would be much higher.

Further, even by DOL's own conservative estimates, the rule is going to cost taxpayers $31.5 billion in total, $2 billion annually, and consume 56,822 paperwork burden hours. For the broker dealers and advisers, DOL estimates that costs of complying with the fiduciary rule could cost upwards of $3.6 billion each year. As a result of these significantly-increased costs, many broker dealers and advisers will be forced to either raise their fees or drop clients with account balances that are too low to be profitable. One study estimates that over 7 million IRAs would fail to qualify for an advisory account due to the balance being too low; almost all retail investors will see their costs increased by an average of 73 to 196 percent; and as many as 360,000 fewer IRAs would be opened each year as a result of the rule. It's important to remember that a majority of investment advisers and their firms are small businesses themselves. In 2016 there were 939,578 American small businesses financial firms. Senator Warren and others defend the fiduciary rule by saying that rescinding or delaying the rule puts money "straight into the hands of giant financial institutions." But, in reality, implementing the fiduciary rule puts many small businesses out of business and hurts main street America.

As it turns out, this conflict of interest rule actually conflicts with most people's best interests. Nobody is opposed to a fiduciary standard for investment advisers, but the standard and the rules implementing the standard should be workable and cost effective. Of course there are bad actors in the investment advisory space, as there are across all industries, but the number of bad actors is miniscule, and the cost of pushing those few should not result in punishing the very retirement savers the rules are meant to protect.

Last year there were nearly 11,000 federally-registered investment advisers (RIAs). In the same year, the SEC pursued 98 standalone cases against bad actor investment advisers, or actions against less than one percent of RIAs. The actions of few should not impact the savings of many. The implementation of a new fiduciary standard would not deter the actions of this small percentage of RIAs, but it would deter many low and middle income savers from appropriately saving from retirement.