Regulation Review

Regulation Review: Fiduciary Proposal Redux

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The Department of Labor (DOL) took a mulligan on its first proposal to regulate financial advisers and recently re-proposed its second version of the so-called “fiduciary rule.” The measure would prohibit financial brokers and other advisers from taking compensation from mutual funds and then giving advice to investors unless they adhere to certain strict mandates. This sea change in the law would force all brokers to move to the more expensive “Registered Investment Adviser” role or charge their clients more money. The pre-publication version of the measure is 120 pages, but the regulatory impact analysis weighs in at 244 pages.

Breakdown

- Total Lifetime Cost of the rule: $5.7 Billion ($570 million annually)
- Total Lifetime Benefits of the rule: $20 billion to $33 billion ($2 billion annually)

Analysis

The proposed fiduciary rule is ostensibly designed to protect investors. Unfortunately, the rule may actually hurt low- and middle-income retirement savers by making investment advice more expensive, like that of “registered investment advisers,” and less available. The consulting firm Oliver Wyman found the first version of the rule could force 12 million to 17 million investors to lose access to their current investment advice. The DOL does not address these downsides in its updated version.

As for costs, at $5.7 billion during the next ten years, the proposal easily qualifies as both “economically significant” and major. DOL projects costs stemming from advisers complying with the relevant “prohibited transaction exemptions.” A component of this burden results from developing and keeping disclosure forms and customer guides, in addition to “a new, comprehensive compliance and supervisory system and procedures and related training programs to adapt to the new uniform fiduciary standard.” In other words, the current broker model would largely be abolished in favor of a one-size-fits-all fiduciary form that may push small investors aside.

As with most significant regulations, the proposal will have a substantial impact on securities brokers. Based on data from the Bureau of Labor Statistics, the affected industry falls under “NAICS 52312, ‘Securities Brokerage.’” According to Census data, the potential geographic distribution could look like this (in millions $):

Most Affected States in Brokerage Industry

Small businesses will incur significant costs if the proposal is finalized. Beyond the flawed conception of large brokers controlling billions of dollars in trading accounts, DOL estimates that there are approximately 20,000 small brokerage firms that will be affected. Small firms could incur costs up to $242,000, essentially the cost of hiring two to three additional employees. Despite the independent estimates that the measure will lead to less investment advice, DOL "does not believe … it will result in a diminution of the amount or quality of advice available to small or other retirement savers."

In total, DOL estimates that the benefits of the new rule will amount to approximately $2 billion annually. That estimate takes its cue from recent work done by the President's Council of Economic Advisers (CEA), which similarly estimated that investments in IRA accounts underperform by 100 basis points when influenced by conflicted advice. Yet CEA's analysis has been criticized for making broad assumptions and extrapolations of more complex academic research to arrive at an overly simplistic aggregate cost of conflicted advice on American savers. The regulatory impact analysis of DOL's new rule appears to follow suit and may invite similar criticism in the upcoming comment period.

Conclusion

At $5.7 billion, that is certainly a tremendous burden to the investment community, and eventually, to the investors as well. Someone must ultimately bear the costs of this figure, through reduced profits, higher prices, or reduced services. All options, including the last two, will actually hurt consumers more than help.