The Department of Labor Conflict of Interest Rule is Already Delivering Benefits to Workers and Retirees: Delay Puts Those Benefits at Risk

Amid rumors that the Trump Administration will act soon to delay, then kill, the Department of Labor’s conflict of interest rule, evidence continues to mount that the rule is already delivering enormous benefits to retirement savers. These benefits come in the form of promised reductions in the toxic conflicts that encourage harmful advice and reduced costs for both investment products and investment advice. The rule, which is due to be implemented in April, is achieving these beneficial results without sacrificing retirement savers’ access to advice or choice in how to pay for that advice. This is good news for those who were understandably concerned by industry claims that the rule would harm less wealthy retirement savers.

With tens of billions of dollars in profits at stake, however, the powerful financial interests opposed to the rule are not going down without a fight. Energized by last November’s election results, financial industry lobbyists have renewed their attacks on the rule. In addition to pursuing lawsuits seeking to overturn the rule in court, they have both urged the Trump Administration and backed legislation to first delay and then kill the rule. Members of Congress who believe working Americans and retirees deserve retirement investment advice that serves their best need to stand firm in opposition to these efforts.

1) Just as intended, the rule is eliminating the most harmful conflicts associated with commission-based advice without eliminating access to commission-based advice.

One of the rule’s most consequential provisions requires firms that receive conflicted compensation, including commissions, to eliminate incentives that encourage and reward advice that is not in customers’ best interest. Recent developments have shown how this one provision is transforming the way commission-based advice is offered, with enormous potential benefits for all investors, not just those saving for retirement.

- Just this month, the Securities and Exchange Commission approved a proposal from Capital Group to create a new class of mutual fund shares for its American Funds that will greatly ease compliance with the DOL rule while preserving investors’ ability to get commission-based advice. Historically, mutual funds have determined how much brokers get paid for recommending their funds. With different funds paying different amounts, this created an incentive for brokers to recommend the funds that paid them the most, rather than those that were the best option for investors. Capital Group is changing this through its appropriately named “clean shares,” which allow the broker, rather than the fund, to determine how much to charge for their services. By allowing brokers to separately price commissions, just as they do when recommending ETFs and individual securities, the shares make it easier for firms to adopt compensation policies that pay...
standardized amounts across different funds and different investments, eliminating the conflicts that are the target of the DOL rule without eliminating commission-based advice. As Morningstar analyst Alec Lucas noted, this will also enhance pricing transparency for brokerage services, allow compensation to be based on the actual level of service provided, and encourage brokers to compete on price as well as service quality. Coming as it does from the largest and most trusted of the broker-sold fund families, this revolutionary change has the potential to deliver enormous benefits to all investors, not just retirement savers.

- While Capital Group has led the way in completely separating sales charges from the cost of running the fund, many other fund firms are responding to the DOL rule by issuing T shares that both dramatically reduce the commissions for broker-sold funds and reduce the compensation-related conflicts associated with those funds. As Morningstar’s John Rekenthaler reported, the T shares are being issued because firms feared existing A shares would not comply with the DOL rule’s fiduciary standard both because their sales charges are high and because broker compensation varies from fund to fund. T shares ease compliance because they have the same sales charge across all fund categories and fund companies, reducing inducements to sell only the funds that pay higher compensation. With T shares carrying a maximum sales load of 2.5 percent, compared with an industry standard for A shares of 4.75 percent (and as high as 5.75 percent), and 12b-1 fees of just 25 basis points, investors will also benefit from the dramatic reduction in cost. Indeed, Rekenthaler notes, these shares have the potential to exert downward pressure on investment advisers’ asset-based fees as well, as advisers seek to remain cost competitive.

By reducing incentives to give harmful advice, these changes help to ensure that investors who prefer to pay through commissions actually receive advice, and not just a sales pitch dressed up as advice. Even in the absence of SEC action, the benefits will extend well beyond retirement accounts. Are investors who see the benefits of buying “clean shares” in their retirement account really going to want the costs and conflicts of “dirty” shares in their taxable accounts? With T shares offering obvious benefits over A shares, A shares are likely to become obsolete.

2) Despite dire predictions to the contrary, most firms are continuing to offer commission-based retirement investment advice.

A popular refrain from Wall Street lobbyists before and after the rule was finalized was that its provisions allowing commission-based advisers to comply with a fiduciary standard – the best interest contract exemption or BIC – were simply unworkable. No firms could or would use the exemption, we were told, and investors would lose access to commission-based retirement investment advice as a result. Here again, events since firms began implementing the rule have given the lie to those dire predictions.

- While some firms, most notably Merrill Lynch, have announced plans to convert all Individual Retirement Accounts (IRAs) to fee accounts, a wide variety of firms have announced plans to rely on the best interest contract exemption in order to continue to offer commission-based retirement investment advice. These include firms as diverse in their business models and client base as Ameriprise, LPL, Cambridge, Cetera.
Morgan Stanley, Raymond James, Mass Mutual, Lincoln Financial Distributors and Lincoln Financial Network and Wells Fargo. Here are a few of the positive statements prominent industry executives have made.

- "We believe the impact from the rule will be very manageable for our business." – Dan Arnold, President of LPL Financial
- “We believe our advisers can most effectively uphold a fiduciary standard of care and work in clients’ best interests by continuing to offer choice.” – Shelley O’Connor and Andy Saperstein, Morgan Stanley’s co-heads of wealth management
- “We’ll embrace the BIC standard.”— John Vaccaro, senior vice president and head of the MassMutual Financial Network
- “We announced about a month ago to our advisers that we will operate to the BIC….And we are working towards that process as we speak.” – Will Fuller, president of Lincoln Financial Distributors and Lincoln Financial Network
- “SunTrust supports the Department of Labor’s Fiduciary Rule and its goal to help provide information that will allow you to make informed decisions about your financial future. The spirit of the Rule embodies our purpose, to help move Americans from financial stress to confidence.” – SunTrust website
- Meanwhile, TIAA has come out in opposition to industry litigation challenging the rule. “The department, in my assessment, ran a good process,” said TIAA CEO Roger Ferguson.

- Instead of fleeing the small account market, two firms that specialize in serving smaller accounts – Edward Jones and LPL – announced shortly after the rule was finalized that they would both lower the minimums on their fee accounts, to $5,000 and $10,000 respectively.

As a result of developments such as these, smaller savers will both retain access to commission-based advice and gain greater access to fee-based advice. In short, the rule is expanding, not reducing, investor choice for these small savers.

3) Far from driving up investors’ costs, the rule is already responsible for significant cost reductions.

Supporters of the rule argued that it would benefit retirement savers by forcing investment products to compete based on cost and quality, rather than simply by compensating sellers more generously. Experience since the rule was adopted has borne out this prediction.

- A number of major firms (Schwab, Blackrock, Fidelity and Prudential among them) have announced plans to reduce costs on certain investment products, such as ETFs and mutual funds, at least in part to be more competitive under the DOL rule. And the broad adoption of T shares discussed above further enforces this point.
- The rule is having a similar impact on pricing of variable annuities, where it is seen as hastening the disappearance of L shares in favor of less costly alternatives.
These changes are not limited to commission accounts.

- When LPL announced it was reducing the account minimums for its fee accounts, it also announced that it was lowering the fees on those accounts.
- Similarly, when Merrill announced its plan to move all IRAs to fee accounts, it also clarified that it was giving advisors flexibility to reduce fees below existing minimums in order to ensure that customers’ costs did not rise inappropriately as a result of the conversion.
- Schwab just announced a new advisory program with a minimum initial investment of $25,000, all-in-costs between 0.36% and 0.52%, and comprehensive financial and investment planning from a CFP professional.

Regardless of whether they invest through commission or fee accounts, retirement savers are likely to see their costs go down, not up. As a result, they will get to keep more of their hard-earned money.

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Working families and retirees are looking to you to protect their retirement savings by opposing all efforts to delay, weaken, or overturn this vitally important rule.