Fatal Flaws of the Fiduciary Regulation

How fiduciary-only regulation would cut access to financial guidance and widen the racial wealth gap.

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Introduction

Americans face significant challenges when it comes to saving for a secure retirement. In a 2021 study, the Employment Benefit Research Institute found "nearly half of employees are concerned with their household's financial wellbeing, citing saving for retirement and having emergency saving as top sources of financial stress."[1] The National Retirement Risk Index (NRRI), developed by the Boston College Center for Retirement Research, indicates that *prior to the pandemic* 50% of households were in danger of lacking sufficient funds to maintain their standard of living in retirement.[2] The economic toll of the pandemic almost certainly means that number has gone up.

With many Americans seeking guidance around retirement savings, such as workplace savings plans and IRAs, policymakers should be looking for ways to make that help as accessible as possible, while protecting consumers.

Some policymakers seek a fiduciary-only approach, which would change the way many retirement savers obtain guidance. This approach would eliminate support from financial professionals who receive *one-time commissions* and leave only fiduciaries available for those with substantial savings willing to pay *ongoing service fees*. Proponents of this approach claim that it would ensure financial professionals act only in the interests of their client. However, studies show that the net effect of a fiduciary-only approach would make guidance unavailable to many who need it.[3][4]

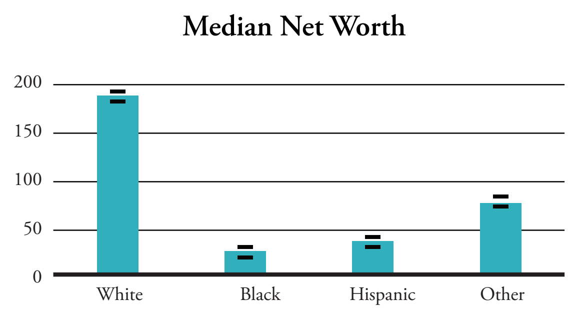
Unfortunately, policymakers in Washington are resurrecting this idea as we are still dealing with a pandemic that is putting increased financial strain on America's working class. Policymakers should not be adopting regulations that push average Americans toward financial professionals favored by the wealthy that could eliminate financial help to the people who need it most.

We need a better approach, one that helps Americans navigate retirement confidently without limiting access to retirement guidance and products. The solution, a Best Interest standard of care, has already been adopted by many financial regulators including the Securities and Exchange Commission. The Best Interest obligations raise the standard of conduct, improve consumer disclosures, directly address potential conflicts of interest, and protect consumer access to commissioned-based financial support needed and wanted by low- and moderate-income savers who cannot meet the fiduciary services six-figure account minimums.

1 https://mailchi.mp/ebri/ozgtpbut8h-1281392
2 https://crr.bc.edu/special-projects/national-retirement-risk-index/
3 https://www.limra.com/contentassets/5b78941a25024890a484fd62389ad11f/the-proposed-fiduciary-rule-plans-providers-perspective
4 https://hispanicleadershipfund.org/wp-content/uploads/2021/11/FINAL_HLF-Quantria_FiduciaryRule_08Nov21.pdf

A Fiduciary Regulation Would Increase the Racial Wealth Gap

According to the Federal Reserve, the average white household in the U.S. today has amassed about seven times more wealth than the average Black household.[5]



Source: Federal Reserve Board, 2019 Survey of Consumer Finances. Pg 2-3

Many Americans do not have enough saved for retirement, but given the persistence of the racial wealth gap, that is especially true among Black and Hispanic Americans. Nearly two-thirds of Hispanic families and more than half of Black families don't have any form of retirement savings account.[67] Hispanic and Black families also typically earn less than others, and their employers are less likely to offer 401(k)s or other retirement savings plans.

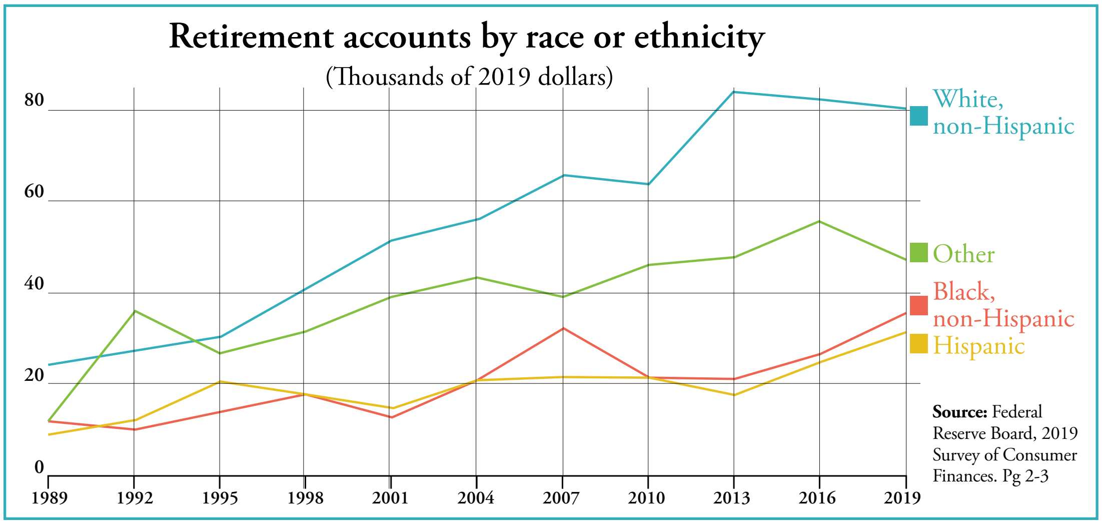
In fact, two-thirds of Latinos[8] work for employers that don't sponsor retirement savings plans and 60% of Black women ages 65+ have no retirement income from savings and assets. Furthermore, according to the NRRI, half of all U.S. households were at risk for falling short in retirement. However, 54% of Black Americans and 61% of Latinos were at risk, compared to 48% of whites.[9]

One of the consequences of the racial wealth gap is that it also leads to a savings gap. The median retirement savings for Black and Hispanic households is less than $30,000. Given that fiduciary-only advisers advisors often require account holders to make initial investments upwards of $100,000, it would exclude the vast majority of Black and Hispanic Americans from accessing retirement savings products.

Making guidance about annuities and other financial products unavailable for working-class Americans will exacerbate the racial wealth gap. In addition, a fiduciary-only regulation will increase the wealth gap by reducing projected IRA balances of Black and Hispanic Americans by 20% over 10 years.[10]

5 https://www.federalreserve.gov/econres/notes/feds-notes/disparities-in-wealth-by-race-and-ethnicity-in-the-2019-survey-of-consumer-finances-20200928.htm
6 https://www.businesswire.com/news/home/20200909005230/en/
7 https://www.axios.com/lower-income-lack-savings-latino-wealth-gap-ba7a51f4-61bf-4d53-b00f-8e930e3921c7.html
8 Unidos https://www.unidosus.org/blog/2015/01/21/latinos-majority-small-business-employees-limited-access-retirement-savings/
9 https://www.forbes.com/advisor/retirement/retirement-racial-wealth-gap/
10 https://hispanicleadershipfund.org/wp-content/uploads/2021/11/FINAL_HLF-Quantria_FiduciaryRule_08Nov21.pdf

A Fiduciary-Only Approach Would Make Financial Guidance Inaccessible for Many Retirement Savers



The main focus of fiduciary-only proponents is the elimination of commission based financial transactions. Architects of this policy argue that financial professionals will look to sell products that generate the highest commission, which may not be what is best for the customer. What a fiduciary-only approach overlooks is that eliminating commission-based services *leaves savers and retirees with less than six-figure account balances without any help at all.*

One particular impact of eliminating commission-based services is on people seeking a guaranteed source of income through retirement.

Annuities are the only financial product in the marketplace that can provide guaranteed lifetime income. They help retirees supplement their Social Security benefits by providing retirees with another source of guaranteed income each month. It's crucial to understand who is buying annuities and why a fiduciary-only, six-figure account minimum fee for service only model would be disastrous. The median total household income of annuity owners is $70,000.[11]

Americans are living longer and need a financial plan to not outlive their savings. Fewer employers offer traditional lifetime pension benefits. Growing numbers of independent and gig workers don't have access to employer-provided retirement tools. Annuities can provide essential financial protection, effectively allowing anyone to *create their own pension.*

Fiduciary-only advisors generally require account holders to invest at least $100,000 up front, which is more than many working-class Americans have in retirement savings. It is also worth noting that fiduciaries generally charge an ongoing asset-based fee. This *assets-under-management fee model* is biased toward wealthy clients with significant assets and against working-class families who would benefit from purchasing an annuity. A fiduciary-only approach would severely limit savings options for Americans looking to secure their financial future. The result could be ruinous to millions of Americans, denying them of hundreds of millions of dollars in retirement savings.

11 https://hispanicleadershipfund.org/wp-content/uploads/2021/11/FINAL_HLF-Quantria_FiduciaryRule_08Nov21.pdf

A Decade of Consumer Protection Policymaking

A fiduciary-only approach was first proposed by the Obama Administration in 2010. After lengthy public comment and a hearing, strong opposition to the proposed regulation caused it to be withdrawn.[12] In 2015, President Obama announced a new proposal which led to a final fiduciary-only regulation in 2016. It was struck down by the 5th U.S. Circuit Court of Appeals in 2018.

Despite the consumer protection goals of the fiduciary-only supporters, in the short time it was in effect, it had a devastating impact on the people it was supposedly designed to help. A Quantria Strategies study released last year found that more than half of financial institutions either limited or eliminated access to brokerage advice for smaller retirement accounts.

In 2019, there was massive progress on charting a better path forward. The Securities and Exchange Commission (SEC) adopted Regulation Best Interest ("Reg BI") that imposes enhanced standards of conduct requirements on broker-dealers and their registered representatives when making a recommendation regarding securities, including variable annuities, to a consumer.[13]

Then, in 2020, the National Association of Insurance Commissioners (NAIC) adopted a model regulation for states to consider that aligns with Reg BI and applies to financial professionals who recommend to consumers annuities that are not equity-based and SEC regulated.[14]More than a third of all states have adopted the new model and more are expected.

That same study projected that if a fiduciary-only approach were to be reinstated, it would reduce the accumulated retirement savings of 2.7 million individuals with incomes below $100,000 by approximately $140 billion over 10 years. That type of impact on working-class Americans would be destructive under any circumstances, but at a time when the coronavirus pandemic continues to take a financial toll on American workers and their families, it would be catastrophic.

A Brief History of Fiduciary Regulation

2010	Fiduciary Rule first proposed By Obama Administration
2011	Obama Administration abandons Fiduciary Rule after strong opposition
2015	President Obama announces updated Fiduciary Rule
2016	Obama Administration produces final Fiduciary Rule
2019	SEC adopts Reg Bi Standard
2020	NAIC adopts model regulation aligning with Reg Bi

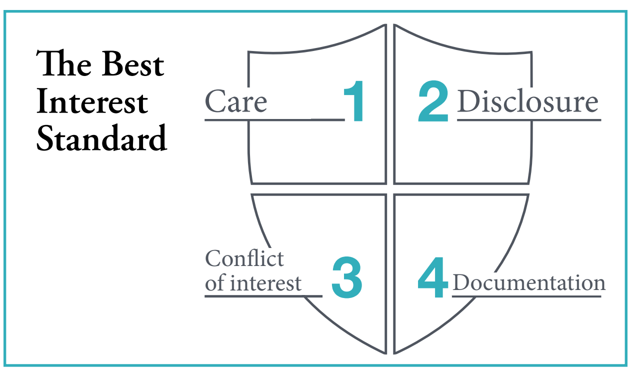
12 https://www.dolfiduciaryrule.com/
13 https://www.sec.gov/news/press-release/2019-89
14 https://content.naic.org/article/news_release_naic_takes_action_protect_annuity_consumers.htm

A Better Way Forward: The Best Interest Standard

Consumers deserve to feel confident when seeking advice about financial guidance and planning, but for a variety of reasons, the fiduciary-only approach is a misguided attempt at achieving this goal. The good news is that there is a way to achieve that goal, without making financial products inaccessible for consumers.

The National Association of Insurance Commissioners (NAIC) revised model regulation on annuity transactions together with the Securities and Exchange Commission's (SEC) Regulation Best Interest (Reg BI) provide a robust framework that protects Americans planning and saving for the future and managing their retirement nest eggs. Implementing a Best Interest standard protects consumers without disenfranchising middle- and working-class families who want access to sound, transparent financial guidance that doesn't impose six-figure account minimums that are way beyond their current nest egg.

The Best Interest standard requires a financial professional to act in the best interest of the consumer without placing his financial interest ahead of the consumer's interest. A financial professionalmust satisfy four conduct obligations to meet the Best Interest standard:



Care Obligation

When making a recommendation to a consumer, a financial professional must act in the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the financial professional ahead of the interests of the consumer.

When recommending an annuity, financial professionals must exercise reasonable diligence, care and skill to have a reasonable basis to believe a recommended annuity effectively addresses the consumer's financial situation, insurance needs and financial objectives.

This means financial professionals are required to make reasonable efforts to obtain key information regarding the consumer's age, annual income, financial situation and needs, financial experience, needs and objectives, intended use of an annuity, financial time horizon, existing assets, liquidity needs, liquid net worth, risk tolerance, tax status, and source of funds to purchase an annuity.

Disclosure Obligation

A financial professional must prominently disclose to the consumer: a description of the scope and terms of the producer's relationship with consumer; a description of the sources and types of cash and non-cash compensation to be received by the producer; and any material conflicts of interest. The NAIC model regulation also requires notice of the consumer's right to request additional information regarding cash compensation, among other things.

Conflicts of Interest Obligation

Financial professionals must identify and avoid or reasonably manage and disclose "material conflicts of interest." This is defined as a financial interest a reasonable person would expect to influence the impartiality of a recommendation. Under the duty of care, a material conflict of interest must not cause a financial professional to place their own interests ahead of the consumer's.

Documentation Obligation

A financial professional is required to: make a written record of any recommendation and the basis for the recommendation; and obtain signed statements from a consumer relating to the consumer's refusal to provide consumer profile information or an annuity transaction that is not recommended by the producer.

Other Consumer Protective Provisions

Broker or dealers and insurance companies must establish, maintain, and enforce written policies and procedures reasonably designed to achieve compliance with Regulation Best Interest. They must establish and maintain reasonable procedures to identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on sales of specific annuities within a limited period of time.

The Best Interest Standard is Already Working

It is clear that a fiduciary-only standard doesn't work, a best-interest standard is in place and working in 19 states across the country. This standard has been implemented through regulation in some states, while other states have enacted the standard through legislation. The 19 states represent a diverse cross-section of America. These states cover every region of the country and are governed by both Republicans and Democrats. The best-interest standard is a common-sense policy that transcends partisan politics.

Conclusion

Half of all Americans are at risk of not having enough money saved to maintain their current standard of living during retirement. This is the case for an even higher portion of Black and Hispanic families. To make matters worse, Americans, particularly working-class families, are still coping with an ongoing pandemic that put millions out of work and forced them to dip into retirement savings.

As we face this retirement savings challenge, we need policymakers to do everything within their power to expand access to financial services, while also protecting consumers. Now is not the time to resurrect failed policies like a fiduciaryonly approach that has been proven to eliminate access to financial guidance for those with smaller retirement accounts and widen the racial wealth gap.

Instead, regulators should adopt a Best Interest standard that will protect consumers, without making access to financial products inaccessible for working-class Americans. Making the correct policy choice will make a big difference to millions of hard-working Americans who seek a secure retirement.