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**STATEMENT**

**OF**

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**PRESIDENT & CEO**  
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**BEFORE THE**

**U.S. HOUSE OF REPRESENTATIVES**  
**COMMITTEE ON WAYS AND MEANS**  
**SUBCOMMITTEE ON OVERSIGHT**

**ON**

**THE DEPARTMENT OF LABOR'S PROPOSED FIDUCIARY RULE**

**SEPTEMBER 30, 2015**

## EXECUTIVE SUMMARY

The key points covered in the body of my statement are summarized below.

### The Department’s Rulemaking Will Hurt—Not Help—Millions of Americans Saving for Retirement

- **We expect the Department of Labor’s proposed fiduciary rule, if adopted, will make retirement savings *more* challenging and costly for retirement savers, particularly those with modest balances.** The Institute supports the principle at the heart of the proposal by the Department of Labor (the “Department”)—financial advisers should act in the best interests of their clients when they offer personalized investment advice. But the added layers of unwarranted complexity and ambiguity that the Department proposes to pile on top of that simple best-interest principle creates the risk that lower- and middle-income savers, and small businesses, will receive *no* advice or guidance, or none that they can afford. For example, even the most basic information—such as that offered in many common call-center and web-based interactions—could trigger ERISA fiduciary status and prohibited transactions. Firms will have little choice but to stop providing that information.
- **The Best Interest Contract (BIC) Exemption cannot be implemented as drafted.** The Department purportedly designed the proposed BIC Exemption to permit broker-dealers and others to continue to receive commissions, notwithstanding their status as ERISA fiduciaries. But the BIC Exemption is loaded with compliance traps and barriers for financial advice professionals and their firms. It also does not provide an adequate “grandfathering” rule for accounts existing before the rule, resulting in retirement savers paying twice for advice.
- **The Institute has provided the Department with constructive recommendations for fixing the proposal’s flaws.** Among our many recommendations, we counseled the Department to provide a reasonable implementation of the BIC Exemption over an appropriate number of years and to adopt a “good faith” compliance mechanism, consistent with previous regulatory initiatives.

### The Department’s Regulatory Impact Analysis Does Not Support the Massive Overhaul of the Retirement Marketplace the Rule Would Impose

- **Claims that retirement savers currently are suffering \$17 billion a year in harm are just wrong.** The White House Council of Economic Advisers (CEA) and Department leadership frequently claim that “conflicted advice costs Americans about \$17 billion in retirement earnings each year.” The claim does not stand up when tested against the data, and constant repetition does not make it any truer. We find that the Department’s proposal, if adopted, will result in net losses to investors of \$109 billion over 10 years.
- **The Department’s claims that broker-sold funds “underperform” are not supported by the very academic studies on which it relies.** The Department relies on several academic studies to support its claims that investors are harmed by their use of brokers. None of these academic

studies actually compares the outcomes of investing with a financial adviser that is a fiduciary to the outcomes of investing with a broker or other financial adviser that is not a fiduciary. These studies also rely on outdated data that fail to reflect fundamental changes in the market for broker-sold funds in the past 10 years. Finally, the Regulatory Impact Analysis misapplies the findings of a key study, leading to a vast overstatement of the rules' potential benefits.

- **Investors' actual experience with broker-sold funds further contradicts the Department's claims.** Publicly available data demonstrate that, contrary to the Department's claims, investors who own funds that are sold with front-end loads during the years 2007 to 2013 actually have concentrated their assets in funds that outperform—not underperform—their Morningstar category. On a sales-weighted basis, investors buying front-end load shares in those years outperformed the average for share classes in the same Morningstar category by 27 basis points. Similarly, publicly available data show that investors concentrate their purchases in front-end load share classes with lower expense ratios and that pay brokers lower-than-average loads—further contradicting the Department's claims of harm to retirement savers.
- **The Regulatory Impact Analysis ignores the cost of investment advice.** The total annual cost for the services provided by brokers and their firms to investors in front-end load funds is about 50 basis points a year. But retirement savers likely will pay more in a fee-based account. A recent study finds that fee-based accounts—the most likely alternative to brokerage accounts—cost investors 111 basis points per year on average, in addition to fund expenses.
- **The Regulatory Impact Analysis fails to account for the societal harm of investors losing access to advice and guidance.** Fee-based accounts may not be available to low- and middle-income individual retirement account (IRA) investors who cannot meet minimum account balance requirements (frequently, \$100,000). Over time, investors who no longer have access to advice are likely to experience lower returns because of poor asset allocation and market timing, or because they incur tax penalties by taking early withdrawals.
- **The Regulatory Impact Analysis fails to meet the minimum standards applicable to agency rulemaking.** The Department's meager attention to the potential harm to investors resulting from its rule proposal is surprising given the proposal's likely impact on retirement savers.

### **Changes in Retirement Policy Should Begin with an Assessment of the Existing System and Should Not Put That System at Risk**

- **The Institute supports policies that would improve access to retirement savings opportunities and make retirement plans more efficient and effective.** These improvements would build upon the strengths of the current system. Unfortunately, many other proposals for reform would undermine or attempt to replace the current system. As is the case with the Department's fiduciary proposal, many of these proposals are promoted without the necessary analysis supporting the need for the change, and without taking account of the harm they could inflict on the very people they are intended to help. Any examination of reforms designed to improve the retirement system must begin with a balanced, accurate assessment of Americans'

retirement prospects and the role that the current system plays in helping American workers reach their retirement goals.

- **The U.S. retirement system is helping millions of Americans achieve a secure retirement.** A wide range of work by government, academic, and industry researchers who have carefully examined Americans' saving and spending patterns, before and after retirement, shows that the American system for retirement saving is working for the majority of American workers and has grown stronger in recent decades. Assets specifically earmarked for retirement have increased significantly over time. Adjusted for inflation and growth in the number of households, retirement assets at year-end 2014 were more than seven times the level at year-end 1975.
- **A multi-faceted retirement savings system has resulted in successive generations of American retirees being better off than in previous generations.** The U.S. retirement system relies upon the complementary components of Social Security, homeownership, employer-sponsored retirement plans (both defined benefit (DB) plans and defined contribution (DC) plans offered by both private-sector and government employers), IRAs, and other savings. In retirement, different households will depend on each of these components in differing degrees, reflecting overall saving levels, work history, and other factors.

#### **The Voluntary Employer-Provided Retirement System Is Characterized by Flexibility, Competition, and Innovation**

- **A strength of the voluntary employer-sponsored retirement system is the flexibility built into its design.** Combined with competition—among employers to offer attractive benefits packages that include retirement plans and among financial services firms to provide services to those plans—this flexibility has led to tremendous innovation in retirement plan design over the past few decades and to continually lower costs for retirement products and services.
- **Retirement plan sponsors and investors are cost conscious and 401(k) plan assets tend to be concentrated in lower-cost mutual funds.** The cost of 401(k) plans has fallen over time while services have expanded. Fees paid on mutual funds in particular have trended down over the past two decades—both on mutual funds invested in 401(k) plans and industrywide—and investors tend to concentrate their assets in lower-cost funds. Employers sponsoring 401(k) plans and their financial services providers have worked together to automate and simplify the enrollment process, expand the range of investment options, expand the services provided by the plans, and broaden the array of educational materials offered participants.

#### **Effective Policymaking Requires a Better Understanding of the “Coverage Gap”**

- **Any assessment of proposals intended to increase coverage must be based on an understanding of the reasons some employers do not offer retirement plans to their workers, and should not be based on snapshots of coverage rates or misleading coverage statistics.** Discussions about pension plan coverage often rely on misleading or incomplete coverage statistics. Efforts to expand coverage will be more successful if they focus on the underlying reasons why specific populations are not participating in retirement savings vehicles.

- **Differences in workforce composition appear to be a primary cause for the lower rate at which small employers sponsor retirement plans.** Employees who work for firms that do not sponsor retirement plans, whether those firms are large or small, are more likely to be younger, have lower earnings, and have less attachment to the workforce. These individuals are more likely to have other more immediate savings needs, such as saving for a home or car. Firms sponsoring retirement plans, on the other hand, have workforces that are older, have higher earnings, and are more likely to work full-time for a full year. Employers that have workforces that are more focused on saving for retirement—and, thus, more likely to value retirement benefits—are more likely to offer retirement plans. The characteristics of small-firm employees as a group differ substantially from the characteristics of large-firm employees—differences that help account for the lower rate of plan sponsorship among smaller firms.
- **Most workers will accumulate retirement benefits during their careers.** Many more workers will have access to an employer-sponsored retirement plan at some point during their working careers and will reach retirement with work-related retirement benefits than a snapshot of coverage among all workers at any point in time would imply. For the past two decades about 80 percent of near-retiree households—those with a working head of household aged 55 to 64 in the year indicated—have consistently accrued DB, DC, or both types of retirement plan benefits (from private-sector employer and government employer plans) or IRAs (rollover and contributory).

### **State-Administered Retirement Plan Proposals Raise Substantial Questions and Merit Close Scrutiny**

- **Among these questions are the following:**
  - What are the implications of an escalating number of different state-administered plans for private-sector workers—for multi-state employers, for workers who move from one state to another, and for the marketplace for retirement plan products and services?
  - Will state-run plan options erode the successes of the current voluntary employer-sponsored system, by prompting employers currently offering plans to drop their 401(k) plans in favor of the state option?
  - What type of investor protections will apply to participants in state-run plans, particularly if state-run plans are exempted from ERISA or federal securities laws?

These and other questions outlined in the testimony below illustrate the complex issues that state-run plan proposals for private-sector employees raise.

- **Policymakers also should consider what changes at the national level might help expand retirement plan coverage and obviate the need for a patchwork of state-administered plans.** Two ideas in particular would help bring more employers into and improve the effectiveness of the voluntary private-sector retirement system, without detracting from the system’s successful features. These ideas—a new type of SIMPLE plan and easier access to

multiple employer plans for small employers—would be based on existing concepts and easy to implement.

## I. INTRODUCTION

My name is Paul Schott Stevens. I am President and CEO of the Investment Company Institute<sup>1</sup> and I am pleased to appear before the Subcommittee on Oversight today to discuss the U.S. Department of Labor’s proposal to redefine the term “fiduciary” in the context of providing investment advice under the Employee Retirement Income Security Act of 1974 (“ERISA”). Chairman Roskam and Ranking Member Lewis, thank you for this opportunity to share our views and for the attention that you and your colleagues are paying to this issue so critical to American retirement savers.

Thanks in no small part to Congress’s efforts to promote retirement savings, Americans currently have \$24.8 trillion earmarked for retirement, with more than half of that amount in defined contribution (DC) plans and individual retirement accounts (IRAs).<sup>2</sup> About half of DC plan and IRA assets are invested in mutual funds, which makes the mutual fund industry especially attuned to the needs of retirement savers.

Under the framework of a voluntary system, Congress has made available the tax structure and savings vehicles necessary to promote savings by American workers, and the competitive private marketplace has provided innovative products and services at increasingly lower costs.<sup>3</sup>

Even with the many successes of the U.S. retirement system, we should always be open to considering ways in which that system can be strengthened further to help even more Americans achieve a secure retirement. For its part, the Institute has been vocal in its support for policies that would improve access to retirement savings opportunities and make retirement plans more efficient and

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<sup>1</sup> The Investment Company Institute (ICI) is a leading, global association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI’s U.S. fund members manage total assets of \$18.2 trillion and serve more than 90 million U.S. shareholders.

<sup>2</sup> At the end of the second quarter of 2015, U.S. retirement assets totaled \$24.8 trillion, DC plan assets were \$6.8 trillion, and IRA assets were \$7.6 trillion. Investors held \$3.6 trillion of IRA assets and \$3.8 trillion of DC plan assets in mutual funds. See Investment Company Institute, *The U.S. Retirement Market, Second Quarter 2015* (September 2015), available at [www.ici.org/info/ret\\_15\\_q2\\_data.xls](http://www.ici.org/info/ret_15_q2_data.xls).

<sup>3</sup> As discussed below, *infra* at p. 41, competition and a growing asset base have contributed to the success of 401(k) plans by reducing plan costs, resulting in cost-effective investing for 401(k) participants. For research on mutual fund fees, see Collins, Holden, Chism, and Duvall, “The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2014,” *ICI Research Perspective* 21, no. 3 (August 2015), available at [www.ici.org/pdf/per21-03.pdf](http://www.ici.org/pdf/per21-03.pdf). For an analysis of the “all-in” fees of 401(k) plans, based on in-depth surveys of plan sponsors, see Deloitte Consulting LLP and Investment Company Institute, *Inside the Structure of Defined Contribution/401(k) Plan Fees, 2013: A Study Assessing the Mechanics of the “All-In” Fee*, New York: Deloitte Consulting LLP and Washington, DC: Investment Company Institute, available at [www.ici.org/pdf/rprt\\_14\\_dc\\_401k\\_fee\\_study.pdf](http://www.ici.org/pdf/rprt_14_dc_401k_fee_study.pdf). For analysis of “total plan cost,” based on Form 5500 and industry data, see BrightScope and Investment Company Institute, *The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans*, San Diego, CA: BrightScope and Washington, DC: Investment Company Institute, available at [www.ici.org/pdf/ppr\\_14\\_dcplan\\_profile\\_401k.pdf](http://www.ici.org/pdf/ppr_14_dcplan_profile_401k.pdf). For insight into the changing services and educational materials provided by 401(k) plans, see Plan Sponsor Council of America member surveys.

effective. Any such reforms, however, must build upon the strengths of the current system—including the important role that the private marketplace plays in its support. Unfortunately, too often those seeking to improve the system ignore these basic tenets and propose changes that would actually harm the very people they intend to benefit.

Regrettably, the Department’s proposal follows this misguided path. If adopted in anything like its current form, the rule would upend the retirement marketplace and do great harm to retirement savers by drastically limiting their ability to obtain the guidance, products, and services they need to meet their retirement goals. It also would increase costs, particularly for those retirement savers who can least afford it. The Institute is not alone in this assessment. In an array of letters and comments, Members of Congress from both parties have expressed concern with numerous aspects of the Department’s rule proposal and urged a variety of important changes.<sup>4</sup>

The many problems with the Department’s proposal may well be explained by the fundamental errors apparent in the Department’s Regulatory Impact Analysis seeking to justify the massive overhaul of the retirement marketplace it would impose. In particular, this rulemaking—which has been ongoing for years—should have been preceded by and predicated on a comprehensive cost-benefit analysis. Such an analysis should have sought to demonstrate, among other things, that any restriction on future access to guidance, products, and services is justified in light of a clear problem best solved by an expansive redefinition of fiduciary duty.<sup>5</sup> It also should have considered less burdensome regulatory alternatives. The Department’s Regulatory Impact Analysis does none of this. Indeed, it altogether fails to consider publicly available data that contradict its conclusions. It likewise fails to consider the significant harm to retirement savers that is sure to result if the Department adopts the rules as currently drafted.

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<sup>4</sup> See, e.g., Letter from Reps. Ann Wagner (R-MO) and David Scott (D-GA) *et al.*, to the United States Department of Labor, dated July 29, 2015; Letter from House Committee on Education and the Workforce Chairman John Kline (R-MN) and Subcommittee on Health, Employment, Labor and Pensions Subcommittee Chairman Phil Roe (R-TN), *et al.*, to the United States Department of Labor, dated July 21, 2015; Letter from Sens. Jon Tester (D-MT) and Angus King (I-ME), *et al.*, to the United States Department of Labor, dated August 6, 2015; Letter from Sen. Claire McCaskill (D-MO), to the United States Department of Labor, dated August 5, 2015; Letter from Senate Finance Committee Ranking Member Ron Wyden (D-OR) and Sen. Debbie Stabenow (D-MI), *et al.*, to the United States Department of Labor, dated August 7, 2015; Letter from Reps. Tony Cardenas (D-CA) and Emanuel Cleaver (D-MO) *et al.*, (96 Democratic member signatories, including 10 House Ways and Means Committee members) to the United States Department of Labor, dated September 24, 2015.

<sup>5</sup> In several letters sent to the Department after the 2010 rule proposal was shelved, Congressional policymakers uniformly emphasized the importance of ensuring that any re-proposal of ERISA’s fiduciary provision be preceded by a comprehensive regulatory impact analysis. See, e.g., Letter from Reps. James Himes (D-CT), Richard Neal (D-MA), and Carolyn McCarthy (D-NY), *et al.*, to the United States Department of Labor, dated November 7, 2011; Letter from Reps. Gregory Meeks (D-NY) and Gwen Moore (D-WI), *et al.*, to the United States Department of Labor, dated March 15, 2013; Letter from House Committee on Education and the Workforce Chairman John Kline (R-MN), House Committee on Ways and Means Chairman Dave Camp (R-MI), Senate Committee on Health, Education, Labor and Pensions Ranking Member Michael Enzi (R-WY) and Senate Finance Committee Ranking Member Orrin Hatch (R-UT), to the United States Department of Labor and the United States Department of the Treasury, dated April 14, 2011.



My testimony today focuses on two key points: First, I will discuss the highly adverse impact the Department's rulemaking proposal will have on the ability of retirement savers—particularly low- and moderate-income savers—to obtain the guidance, products, and services they need to meet their retirement goals. In this connection, I will demonstrate why the Department's Regulatory Impact Analysis utterly fails to justify its expansive proposal and why, if its proposal is adopted, it will do significant net societal harm. Significantly, if the Department adopts the proposed rules without very substantial changes, the Institute estimates that retirement investors' returns could be reduced, conservatively, by \$109 billion over 10 years as a result of the additional fees and lost returns they will incur. If, on the other hand, the Department reassesses its Impact Analysis in light of our comments, it will make policy choices that meet its goals while making its final rules simpler, more workable, and better for investors.

Second, my testimony will describe the strengths and successes of the U.S. retirement system and the important role that the private marketplace plays. I also will discuss why efforts to mandate state-administered retirement plans should be scrutinized with care. Such efforts raise many questions that Congress should explore. Policymakers also should consider what changes at the national level might help expand retirement plan coverage and obviate the need for a patchwork of state-administered plans. The Institute has proposed targeted reforms at the national level that would help bring more employers into the system and generate better outcomes for retirement savers—importantly without detracting from the system's effective features.

## **II. THE DEPARTMENT'S RULEMAKING WILL HURT—NOT HELP—MILLIONS OF AMERICANS SAVING FOR RETIREMENT**

Some of the practical, human implications of the Department's proposal are underscored for me by an experience I recently had helping one of my adult children through a job transition. This is something some of you may have experienced. My son is in his 20s and recently left his first full-time job to take a position with a new company halfway across the country. He was a liberal arts major in college, more a student of history than of finance. And, young as he is, his personal financial experience is limited. After he got settled in his new job, we discussed what he might do with the 401(k) balance he had in his former employer's plan. The amount was modest—less than \$10,000—but it was hard earned and if well managed over a long investing horizon it might amount to much more later in his life. Clearly, he wanted to do the right thing but was not sure exactly what that would be. In particular, he needed information that would help him to make a good decision for himself.

I suggested that we call a mutual fund company for information about its products and services, and my son agreed to have me sit in on the conversation. (I suggested a fund company knowing that the amount in question, while important to my son's future, was too small to interest a fee-based investment adviser.) The call center representative of the mutual fund company patiently walked my son through various options, outlining factors relevant to keeping the account in the former employer's plan or rolling it over to an IRA. He explained important investment considerations, like asset allocation and the need for diversification. He also described the various kinds of funds that the fund company offers and how they might help meet my son's savings goals. The conversation with the call

center representative certainly validated my son’s instinct to keep his modest balance at work for his retirement. But at no time did the representative cross the line and presume to act as an adviser, and the interaction clearly did not create the relationship of trust and confidence that is characteristic of a fiduciary.

Although my son spent close to an hour talking to the call center representative, the information and help came at no cost to him. But it equipped him to make a good decision, in light of his own situation and preferences. Ultimately, my son decided to roll over his 401(k) plan assets into an IRA and invested those assets in one of the mutual fund company’s target date funds, which best matched his decision to concentrate his balances in a single product offering a diversified portfolio of stocks and bonds that adjusts over time.

There are hundreds of thousands of retirement savers like my son in your home states and across our country—young men and women just starting out, people with less financial sophistication for whom help and information are critically important, and workers trying to make the most of small accounts. It is essential to ask: how will the Department’s proposal affect them?

The answer: the wide net cast by the Department’s proposal threatens to eliminate or severely reduce these very types of commonplace exchanges of information—provided at no cost to millions of retirement savers through call centers, walk-in centers, and websites. Particularly troubling, the proposal would require firms that offer primarily proprietary investment products to forego the ability simply to explain to a retirement saver how their products and services may meet the retirement saver’s needs.

In the future, under the Department’s proposal, such exchanges would have to take place under a cumbersome and convoluted contractual relationship required by the so-called “Best Interest Contract” Exemption. As described below, this so-called exemption—replete with compliance burdens and litigation risks—gives every appearance of having been devised in such a manner that it was never intended to be used. Certainly, it will pose very significant barriers to the type of commonplace interactions described above and no doubt will occasion substantial additional costs.

To be clear, the Institute has been and remains ready to assist the Department in every way possible to get its fiduciary proposal right. We have provided the Department three detailed comment letters on the proposed rule defining the term “fiduciary,”<sup>6</sup> the proposed exemptions in connection with that definition,<sup>7</sup> and the Regulatory Impact Analysis justifying the Department’s proposals.<sup>8</sup> A fourth letter I sent to Secretary Perez highlights the key areas of the rule proposal that we believe make it unworkable and conveys at a high level the changes we urge the Department to make to the proposed

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<sup>6</sup> Letter from David Blass and David Abbey, ICI, regarding the proposed fiduciary rule (July 21, 2015), available at [www.ici.org/pdf/15\\_ici\\_dol\\_fiduciary\\_def\\_ltr.pdf](http://www.ici.org/pdf/15_ici_dol_fiduciary_def_ltr.pdf).

<sup>7</sup> Letter from David Blass and David Abbey, ICI, regarding the proposed best interest contract exemption (July 21, 2015), available at [www.ici.org/pdf/15\\_ici\\_dol\\_fiduciary\\_best\\_interest\\_ltr.pdf](http://www.ici.org/pdf/15_ici_dol_fiduciary_best_interest_ltr.pdf).

<sup>8</sup> Letter from Brian Reid and David Blass, ICI, regarding the Department’s Regulatory Impact Analysis (July 21, 2015), available at [www.ici.org/pdf/15\\_ici\\_dol\\_fiduciary\\_reg\\_impact\\_ltr.pdf](http://www.ici.org/pdf/15_ici_dol_fiduciary_reg_impact_ltr.pdf).

rules.<sup>9</sup> The letters spell out the many serious flaws in the rule proposal that collectively make it hopelessly unworkable. The letters also advance numerous constructive suggestions for improving the rules as proposed. We also testified at the Department’s recent public hearings and supplemented our earlier comments in response to questions raised by representatives of the Department at the hearing.<sup>10</sup> While I summarize the key changes we recommend later in my testimony, it is instructive to first appreciate just how damaging the Department’s rulemaking will be on the ability of savers to engage in even the most commonplace of financial interactions.

#### **A. The Department’s Overly Expansive and Ambiguous Fiduciary Definition Will Impede Commonplace Financial Interactions That Retirement Savers Now Take for Granted**

The Department has proposed criteria for triggering “fiduciary” status that are so expansive and ambiguous that they would serve to establish a vast new regulatory regime over the retirement marketplace. The criteria fail to distinguish between circumstances in which individuals and fiduciaries have a reasonable expectation of a fiduciary relationship and those interactions where there can be no such reasonable expectation. This is a matter of the deepest concern.

ERISA is a uniquely prescriptive statute. It expressly prohibits an ERISA “fiduciary” from engaging in many routine transactions. Most importantly, ERISA prohibits a fiduciary from performing services as a fiduciary that affect the compensation that the fiduciary receives. This prohibition applies regardless of whether the outcome resulting from such services is in the best interest of the recipient. Rules governing what activities give rise to a fiduciary relationship accordingly must provide genuine clarity about who does or does not have that status.<sup>11</sup> These rules must facilitate commonplace financial interactions and must allow plans and retirement savers to obtain investments that meet their needs and to gather a range of market input on which to base decisions.

#### **B. The Department’s BIC Exemption Will Not Mitigate the Harm Caused by Its Overly Expansive and Ambiguous Fiduciary Definition**

The Department suggests that the impact of its expansive fiduciary definition—like the inability to engage in helpful interaction—will be mitigated substantially by the BIC Exemption proposed along with its rule proposal. We strongly disagree. That exemption as currently drafted is quite useless because of the multitude of ambiguous and impractical conditions to which it is subject. Thus, for example, the BIC Exemption would require that a retirement saver to enter into a three-party written contract and receive a mountainous disclosure document before engaging in any conversation with the call center representative. This hardly would create an environment that would encourage a

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<sup>9</sup> Letter from Paul Schott Stevens, ICI, to Thomas E. Perez, Secretary, U.S. Department of Labor (July 21, 2015) available at [www.ici.org/pdf/15\\_ici\\_dol\\_fiduciary\\_overview\\_ltr.pdf](http://www.ici.org/pdf/15_ici_dol_fiduciary_overview_ltr.pdf).

<sup>10</sup> The Institute’s supplemental letter on the proposed Conflict of Interest Rule and proposed Best Interest Contract Exemption is available at [www.ici.org/pdf/15\\_ici\\_dol\\_rule\\_comment.pdf](http://www.ici.org/pdf/15_ici_dol_rule_comment.pdf). The Institute’s supplemental letter on the Regulatory Impact Analysis is available at [www.ici.org/pdf/15\\_ici\\_dol\\_ria\\_comment.pdf](http://www.ici.org/pdf/15_ici_dol_ria_comment.pdf).

<sup>11</sup> Testimony of Paul Schott Stevens before the Department (March 1, 2011), available at [www.ici.org/policy/ici\\_testimony/11\\_dol\\_fiduciary\\_tmny](http://www.ici.org/policy/ici_testimony/11_dol_fiduciary_tmny).

young saver to seek out information from providers about products and services needed to make informed investment choices.

It is widely understood that financial services firms will not be inclined to subject themselves to the multitude of ambiguous and impractical conditions required of those who wish to rely on the BIC Exemption. The exemption's requirement of a prior contract, its requirements for voluminous fee reporting and disclosure, and its overwhelming data creation and retention requirements, not to mention the substantial threat of unwarranted litigation,<sup>12</sup> all undermine the usefulness of the exemption. The result will be far reaching. Savers who today rely on brokers and other commission-based advisers for investment services no longer will be able to do so. They will be forced either to engage fee-based advisers, significantly increasing their investment expenses, or to go without information and guidance—the most costly course of all.

Indeed, adopting the current proposals could well reduce the current level of competition in the market by making it more difficult for investors to switch from one fund manager to another or from one financial adviser to another. This outcome would harm, not help, investors who need and want financial advice to make informed investment decisions—potentially setting back the success of generations of retirement savers and putting at risk our nation's progress on retirement security.

### **C. “Robo Advice” Is Not a Panacea for an Unworkable Fiduciary Rule**

Secretary Perez contends that small savers might be better off working with “robo advisers”—*i.e.*, computer-programmed advice delivered on-line—than with human representatives of financial services firms. The “robo-advice” service model is relatively new. The Institute strongly supports innovation and we understand that for some investors getting “robo” advice online may be appropriate. While online guidance certainly has a helpful and growing role to play in helping savers, it is foolhardy to conclude that those services are a suitable substitute for human interactions for all the millions of small savers that will be impacted by the proposed rule and in all circumstances, including periods of great market volatility.

ICI's members reported sharp increases in the volume of investor contacts through their call centers during the sharp swings in equity markets in late August and early September of this year. During episodes such as this or the fall of 2008, an email, text message, or website alert from a “robo adviser” is not likely to suffice to keep millions of concerned savers from selling into a stressed market, with devastating consequences for their nest eggs.

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<sup>12</sup> The Department exceeds its authority by creating, through the BIC Exemption, a new private right of action for IRA holders to sue advice providers for breach of contract, *see Alexander v. Sandoval*, 532 U.S. 275, 286 (2001) (“... private rights of action to enforce federal law must be created by Congress ...,” which will undoubtedly serve to increase the cost and reduce the availability of advice and products.)

It is particularly curious that many of the very same organizations that oppose efforts to make better use of the Internet for delivery of information to investors<sup>13</sup> and plan participants,<sup>14</sup> support the Department's rule proposal that seems intent on sending many retirement savers to robo advisers. In lobbying against Internet-based solutions to document delivery, such groups often cite the existence of an alleged "digital divide" in which individuals in certain ethnic groups, occupations, or income levels are less likely to have computers at home or access to the Internet. Yet, neither these organizations nor the Department offer any explanation as to why these very same people would not also be vulnerable to a shift to Internet-based advice services.

#### **D. The Institute Recommends Revisions to the Department's Rule Proposal**

The Institute's detailed comment letters highlight the many serious flaws that, we believe, collectively make the Department's proposal impossible to implement. The letters also advance numerous constructive suggestions for improving the rules as proposed. The key recommended changes identified in our comment letters are as follows:

1. **Draw a commonsense—and clear—line between the provision of fiduciary advice and that of information and education.** Chief among our recommendations is greater clarity regarding what results in the provision of fiduciary advice. The Department must craft the definition of fiduciary advice more carefully to capture only individualized recommendations that are intended for a retirement saver to rely on to take a specific action. We provided alternative text in our comment letter that would accomplish this goal.
2. **Do not treat selling an investment product or service as a fiduciary act.** Small employers, as well as retirement savers generally, should have the option to choose among a wide range of investment products and services. Service providers should be able to provide investors with information and data about those options, both during the sales process and on an ongoing basis. As we demonstrate in our comment letters, there is compelling evidence that Congress did *not* intend for ERISA to disrupt the lawful functioning of the securities markets, to prevent retirement investors from accessing investments, or to turn the "ordinary functions of consultants and advisers" into fiduciary activities.<sup>15</sup> The Department's proposals, at a minimum, should conform to Congress's clear intent in the underlying statute and provide a meaningful seller's exception that covers all savers and applies to true marketing and sales activities.

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<sup>13</sup> See letter from Barbara Roper, Consumer Federation of America, regarding SEC Proposal, Investment Company Reporting Modernization (July 29, 2015), available at [www.sec.gov/comments/s7-08-15/s70815-40.pdf](http://www.sec.gov/comments/s7-08-15/s70815-40.pdf).

<sup>14</sup> See Letter from AFL-CIO, Consumer Union, Pension Rights Center and others to Department of Labor Assistant Secretary Phyllis C. Borzi (April 19, 2012), available at [www.pensionrights.org/sites/default/files/docs/120419\\_group\\_letter\\_and\\_memorandum\\_on\\_electronic\\_disclosure.pdf](http://www.pensionrights.org/sites/default/files/docs/120419_group_letter_and_memorandum_on_electronic_disclosure.pdf).

<sup>15</sup> See ERISA Conference Report, P.L. 93-406, at 323 ("... the ordinary functions of consultants and advisers (other than investment advisers) may not be considered as fiduciary functions ...").

3. **Modify the BIC Exemption.** As explained above, and in detail in our comment letters, the BIC Exemption’s requirement of a pre-advice contract, its voluminous fee reporting and disclosure requirements, and its overwhelming data creation and retention requirements, not to mention the substantial threat of unwarranted litigation, all threaten the usefulness of the exemption. A better approach is to heed Secretary Perez’s call to give sufficient flexibility and discretion to allow fiduciaries to determine how best to satisfy their duties in light of the unique attributes of their businesses and, I would add, the needs of investors. If it actually intends the BIC Exemption to have any practical value, the Department should simplify it as follows:
- ***Take a truly principles-based approach.*** The BIC Exemption will work only if the Department strips it of excessive conditions. A starting point would be eliminating the proposed contractual warranties and representations. They are not needed to protect investors and only serve to expose firms to significant new litigation risk.
  - ***Streamline the required disclosures.*** The proposed disclosures needed to qualify for the BIC Exemption are redundant, granular, costly, and unreasonable. As proposed, these disclosures would serve only to overwhelm retirement investors, in the unlikely event that investors actually read them. The Department should revise the disclosure conditions to align them with the far more workable precedents the Department has adopted under ERISA sections 408(b)(2) and 404(a).
  - ***Expand the scope of coverage of the BIC Exemption.*** The BIC Exemption contains exclusions and limitations that needlessly harm broad classes of retirement plans and savers. The BIC Exemption takes a “legal list” kind of approach—long ago abandoned by mainstream trust law—in proposing a list of certain favored investment choices and eschewing other investment choices not on the list. As a result, the proposed rules would unnecessarily and inappropriately restrict retirement investors’ choices. This is, quite simply, an altogether improper role for the Department or any other regulator, and it should have no place in a final rule. In addition, the Department must expand the BIC Exemption to cover advice provided to all small employers. There is absolutely no sound policy justification for refusing sponsors of small plans access to information and advice about the retirement plans they sponsor and administer.
  - ***Eliminate compliance traps.*** The proposed written policies and procedures requirement for “material conflicts of interest” pose insuperable compliance hurdles for advice providers. The Department must clarify and simplify these requirements.
4. **Avoid retroactive application of the rules.** The Department must modify the proposed exemption so that it does not unnecessarily harm retirement savers by prohibiting ongoing advice on assets acquired prior to the rules’ implementation dates. Savers who bought investments using the services of a broker, for example, already have paid some form of fee for the advice they received. It would be an absurd, quite harmful outcome if the

Department's rule results in those savers receiving no further advice for those investments or paying twice for advice (which would be the case if the Department effectively requires moving the assets, which have already incurred a commission, to a fee-based account).

5. **Provide a meaningful and orderly implementation period.** Even if the Department makes the changes needed to make its rule workable, implementing the rule in an orderly fashion will be a challenge. We strongly recommend that the Department provide an implementation period that allows financial services firms to work with the millions of retirement savers to arrive at an account choice that works best for those savers.
6. **End speculation about special rules for products the Department finds worthy.** The preamble accompanying the proposed BIC Exemption suggests that the Department might craft a "streamlined" exemption from ERISA's prohibitions for so-called "high-quality low-fee" investment products. This idea is both premature and disconcerting. Not only has the Department failed to provide sufficient information about this aspect of its proposal to allow the public to comment in any meaningful way, but its assumption that a durable, universal definition of investment quality can or should be determined by a federal agency is troubling.

### III. THE DEPARTMENT'S REGULATORY IMPACT ANALYSIS DOES NOT SUPPORT ITS PROPOSAL

Given the massive new restrictions on access to guidance, products and services that the Department has proposed, one might expect its Regulatory Impact Analysis (RIA) to provide compelling and unequivocal evidence of a vast market failure necessitating nothing less than an expansive new definition of fiduciary status. In fact, the Department's RIA is fatally flawed: it simply does not support the Department's assertion that there is a "substantial failure of the market for retirement advice."<sup>16</sup> It also does not properly consider how the proposal actually could limit retirement savers' access to guidance, products, and services, or how such limits could affect savers—particularly lower- and middle-income savers with smaller account balances.

The Department bases its RIA on the contention that broker-sold funds "underperform," "possibly due to loads that are taken off the top and/or poor timing of broker sold investments."<sup>17</sup> The Department's analysis does not, however, provide a benchmark for returns against which it measures this claim of "underperformance."

The Department uses a confusing array of claimed loss estimates. It presents different assessments of what underperformance could cost IRA mutual fund investors based on alternative calculations. Under one calculation, it contends that such underperformance could cost IRA mutual

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<sup>16</sup> DOL, *Fiduciary Investment Advice Regulatory Impact Analysis* (Apr. 14, 2015), at p. 7, available at [www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf](http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf).

<sup>17</sup> *Id.*, at p. 98.

fund investors \$18 billion per year<sup>18</sup>—a number close to the claim made by the White House Council of Economic Advisers (CEA) and often cited by Department leadership that “conflicted advice costs Americans about \$17 billion in retirement earnings each year.”<sup>19</sup>

Regardless of the number used—the Department’s \$17 billion or the CEA’s \$18 billion per year—the claims have *no basis in fact*. The calculations underlying these numbers misinterpret and incorrectly apply the findings of the very same academic research cited as the foundation of the claims, and do not consider the significant harm to retirement savers that is sure to result if the Department adopts the rules as currently drafted. In fact, these assertions do not stand up when tested against actual experience and data.

Correcting for the Department’s many errors and omissions, we find that the Department’s proposal, if adopted, will result in net losses to investors of \$109 billion over 10 years.

#### **A. The Department’s Claims That Broker-Sold Funds “Underperform” Are Not Supported by the Very Academic Studies on Which It Relies**

The RIA points to a set of academic studies to buttress its claims that investors are harmed by their use of brokers, but these studies do not support its sweeping claims.<sup>20</sup>

- 1. The academic research does not support the RIA’s statement that “[a] wide body of economic evidence supports a finding that the impact of these conflicts of interest on investment outcomes is large and negative.”<sup>21</sup>**

There are three overarching problems with using the research cited in the RIA to argue that investors using brokers earn lower returns than if they received advice from a fiduciary.

First, none of these academic studies actually compares the outcomes of investing with a financial adviser that is a fiduciary to the outcomes of investing with a broker or other financial adviser that is not a fiduciary. Thus, the findings of underperformance cited in the RIA do not actually measure—and cannot measure, based on these studies—whether an investor using a fee-based ERISA fiduciary adviser would experience a different investment outcome than an investor using another financial adviser that is not an ERISA fiduciary.

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<sup>18</sup> *Id.*, at p. 93.

<sup>19</sup> CEA, *The Effects of Conflicted Investment Advice on Retirement Savings*, (Feb. 2015), p. 21. The CEA white paper is available at [www.whitehouse.gov/sites/default/files/docs/cea\\_coi\\_report\\_final.pdf](http://www.whitehouse.gov/sites/default/files/docs/cea_coi_report_final.pdf).

<sup>20</sup> In our comment letter on the Regulatory Impact Analysis (“RIA Letter”), we discuss each of the articles cited by the Department and explain why they do not support these statements. See RIA Letter, at pp. 11–16. For reasons of brevity, we do repeat that discussion here. Because it is instrumental to the claims advanced in the RIA, a paper by Christoffersen *et al.*—that purports to measure the cost to investors of investing in funds sold through brokers—is described in detail below.

<sup>21</sup> RIA at p. 7.



Instead, these studies seek to measure indirectly how investors fare when receiving assistance from financial professionals who are not fiduciaries, by comparing the performance of funds sold through brokers (“broker-sold” funds) with that of funds sold directly to investors (“direct-sold” funds). The inference that these studies make is that any difference in performance by investors using brokers could be the result of the brokers’ conflicts of interest. This is a leap of logic and is not a direct test of the outcomes of using a financial professional that is not a fiduciary (as compared with using one that is a fiduciary).

Second, most of the studies measure the relative performance of broker-sold funds using data from the 1990s and early 2000s. Fundamental changes in the mutual fund markets since that time have made these studies out of date. Fifteen to twenty years ago, mutual fund markets were segmented, with little head-to-head competition between broker-sold funds and direct-sold funds or funds that did not charge a load (“no-load” funds). Several of the academic papers argue that this segmentation led to broker-sold funds having weaker competitive pressures to produce returns.<sup>22</sup>

Reliance on these studies ignores significant changes in the mutual fund markets. For example, in 2000 only about half of the funds with a front-end load share class also had no-load share classes (Figure 1).<sup>23</sup> By 2010, however, 90 percent of funds with a front-end load share class also offered a no-load share class. These no-load share classes are available on investment-only 401(k) platforms, at discount brokerages, and through fee-based advisory firms. This head-to-head competition between broker-sold funds and no-load funds has transformed the market for mutual funds.

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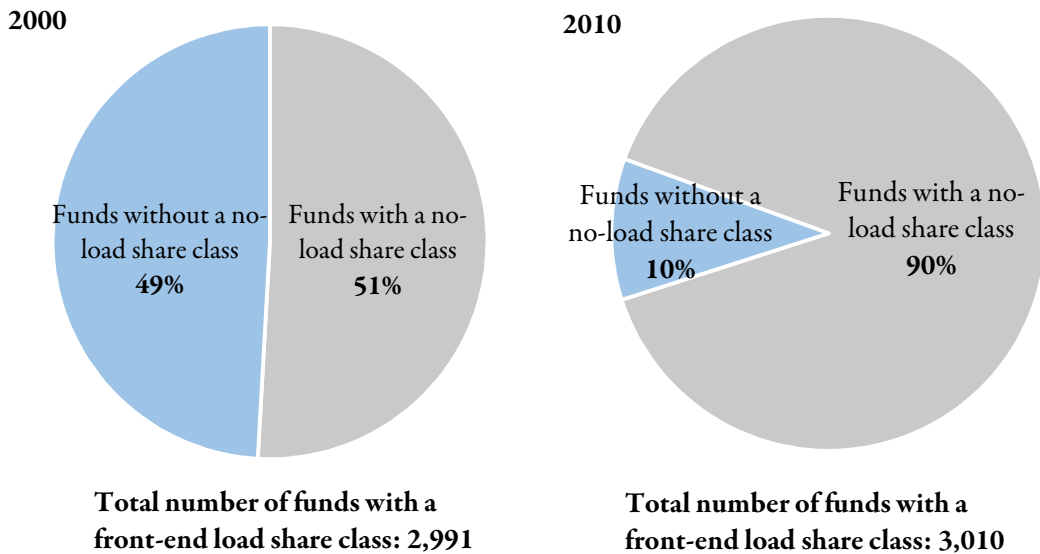
<sup>22</sup> See Daniel Bergstresser, John Chalmers, and Peter Tufano, “Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry,” *Review of Financial Studies* 22, no. 10 (2009): 4129–4156; Diane Del Guercio and Jonathan Reuter, “Mutual Fund Performance and the Incentive to Generate Alpha,” *Journal of Finance* 69, no. 4 (2014): 1673–1704; and Susan Christoffersen, Richard Evans, and David Musto, “What Do Consumers’ Fund Flows Maximize? Evidence from Their Broker’s Incentives,” *Journal of Finance* 68 (2013): 201–235.

<sup>23</sup> Throughout the comment letter, we exclude money market funds, variable annuities, and funds of funds. Money market funds constitute less than 0.1 percent of front-end load fund assets at year-end 2014. Including funds of funds would have created double counting in some of analysis, so we excluded them in all of the analysis. Funds of funds account for 6.6 percent of the front-end load fund assets.

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**Figure 1**  
**Front-End Load Funds with No-Load Share Classes Have Risen Since 2000**

*Percentage of funds with a front-end load share class; 2000 and 2010*



Note: The analysis includes equity, balanced, and bond mutual funds with at least one share class with a front-end load, excluding mutual funds available as investment choices in variable annuities and mutual funds that invest primarily in other mutual funds (funds of funds).

Sources: Investment Company Institute and Lipper

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Third, only one study that the RIA cites (Bergstresser *et al.*) assesses the performance of investors using broker-sold funds on an asset-weighted basis. By contrast, the other studies look at individual fund performance. Asset-weighted and sales-weighted returns provide a superior measure of overall market impact by showing how the average dollar invested with a broker-sold fund performs. Another reason for using asset- or sales-weighted returns is that the RIA seeks to measure the proposal's impact on a market-wide basis. Asset- or sales-weighted measures of performance are necessary to make such calculations.

Asset- and sales-weighted performance measures also are useful for determining if brokers are directing investors to lower performing funds. If the asset- and sales-weighted performance of broker-sold funds is below the returns on the average fund, that would provide evidence of brokers steering investors to funds with weaker performance. If, instead, the asset- and sales-weighted performance of broker-sold funds is higher, then brokers are directing clients to funds that outperform, and this would cast doubt on the argument that there is a widespread market failure.

These three problems with the academic literature highlight why it is inaccurate for the RIA to claim that “[a] wide body of economic evidence supports a finding that the impact of these conflicts of

interest on investment outcomes is large and negative.”<sup>24</sup> Furthermore, the academic literature does not support the statement that a “careful review of this data ... consistently points to a substantial failure of the market for retirement advice”<sup>25</sup> and “that IRA holders receiving conflicted investment advice can expect their investments to underperform by an average of 100 basis points per year over the next 20 years.”<sup>26</sup>

## **2. The RIA’s reliance on Christoffersen *et al.* is misplaced.**

The RIA rests heavily on a paper by Christoffersen, Evans, and Musto (2013).<sup>27</sup> As discussed in detail in our comment letter on the RIA,<sup>28</sup> this paper has two fundamental errors that the RIA repeats. These errors present a false impression of the relationship between fund performance and the payments of front-end loads to brokers. Christoffersen *et al.* finds evidence that a subset of funds—those whose front-end loads result in higher broker compensation than can be explained by the average of similar funds—underperformed the average return of their fund category during the next year. The Department, based on an incorrect assumption that all IRA assets that are invested in front-end load funds suffer the same underperformance, erroneously applies this result from a small subset of load funds to all load funds. Once these errors are corrected, the sweeping statements in the RIA about brokers’ incentives and investor harm collapse.

These errors, on top of certain other misinterpretations made in the Christoffersen *et al.* paper, invalidate the RIA’s assertion that the typical investment in a broker-sold fund underperforms by 100 basis points. In turn, that claim of 100-basis-point underperformance is the foundation for the Department’s claim that, unless it adopts its proposed rules, investors in front-end load funds will lose \$500 billion to \$1 trillion in foregone returns during the next 20 years.<sup>29</sup> In fact, that claim is mere hyperbole, unsupported by the data.

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<sup>24</sup> See RIA at p. 7.

<sup>25</sup> *Id.*

<sup>26</sup> *Id.*

<sup>27</sup> Susan Christoffersen, Richard Evans, and David Musto, “What Do Consumers’ Fund Flows Maximize? Evidence from Their Broker’s Incentives,” *Journal of Finance* 68 (2013): 201-235. Christoffersen *et al.* claims to find that funds that compensated brokers with higher-than-average loads, adjusting for a set of fund features, earned lower returns than funds in the same Morningstar category. As with the other papers that the RIA cites, Christoffersen *et al.* do not measure or test whether these returns were lower than what investors would have received had they used a fiduciary adviser. Nor does the paper provide asset-weighted or sales-weighted returns to demonstrate how investors who use broker-sold funds performed as a group relative to those using similar funds in their Morningstar category. Finally, the sample period used in the paper extends from 1993 to 2009, relying largely on fund performance that is 10 to 20 years old.

<sup>28</sup> See RIA Letter at pp. 13–15.

<sup>29</sup> *Id.*

## **B. Investors' Actual Experience with Broker-Sold Funds Contradicts the Department's Claims**

The RIA does not contain any independent analysis of fund performance to support its claim of underperformance arising from investors' use of brokers that are not fiduciaries. We are not aware of any data available to measure directly how investors using brokers fare relative to investors using fiduciaries. Instead, given the shortcomings of the academic literature and flawed analysis the RIA relies on to support its claims of "underperformance," we undertook our own analysis of the recent actual performance of fund investors in broker-sold funds. As discussed below, our findings contradict the RIA's "underperformance" claims. We find that front-end load funds outperform the average fund with the same investment objective and only slightly underperform the sales- or asset-weighted returns on retail no-load funds.

### **1. Contrary to the Department's claims, investors who own funds that are sold with front-end loads actually have concentrated their assets in funds that outperform—not underperform—their Morningstar category.**

To measure the experience of investors in broker-sold share classes, we use gross sales and assets of front-end load share classes from 2007 through 2013. The reason for focusing on the more recent time period is that the mutual fund market has changed significantly in the past 20 years, as we discussed above.<sup>30</sup> We then calculate fund returns, net of fund fees, based on Morningstar data.<sup>31</sup>

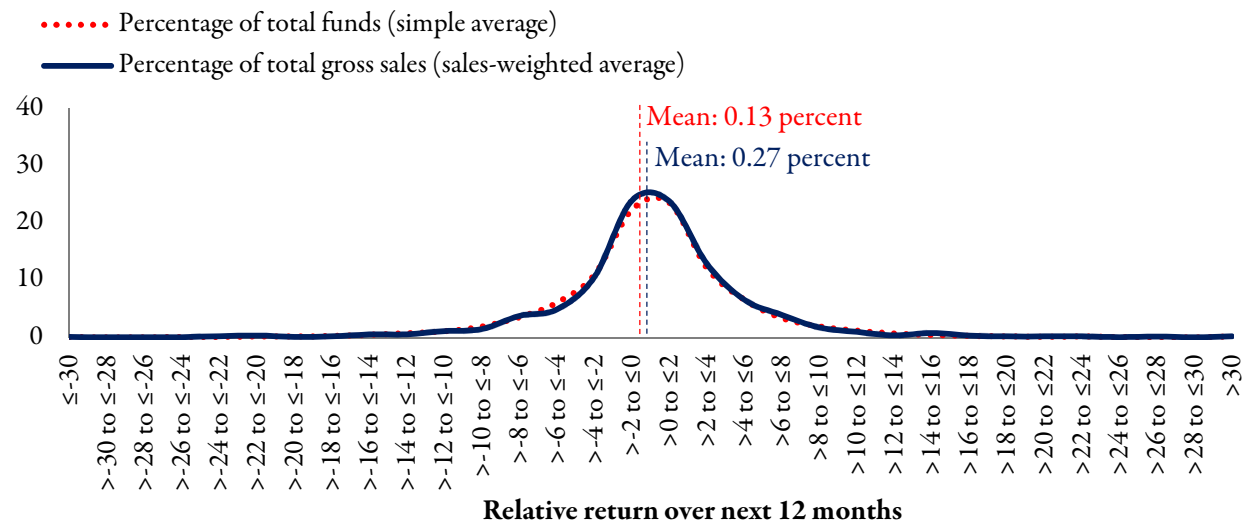
Using sales data from 2007 through 2013, we find that front-end load share classes tended to perform better than their Morningstar category average, and that investors concentrated their purchases (*i.e.*, fund sales) in better performing front-end load share classes. As Figure 2 shows, weighting each share class's relative return by its previous year's gross sales as reported by funds to the ICI, the sales-weighted one-year relative return was 27 basis points. In other words, investors buying front-end load shares in those years outperformed the average for share classes in the same Morningstar category by 27 basis points. The simple-average outperformance of front-end load share classes was 13 basis points during this period. The fact that the sales-weighted average exceeds the simple average suggests that brokers tended to guide their clients to funds that subsequently slightly outperformed, not underperformed, the average front-end load share class.

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<sup>30</sup> Our analysis begins in 2007 because the shift to direct competition between broker-sold and direct-sold funds continued to occur in the mid-2000s. The analysis ends with funds' performance in 2014, the last full year of performance data.

<sup>31</sup> ICI maintains a survivorship-bias free database of Morningstar data.

**Figure 2**  
**Annual Returns on Front-End Load Share Classes Relative to Their Morningstar Category**  
**Returns**  
 2008–2014



Note: The relative return is calculated by taking the one-year return of a share class of a fund (net of expenses) less the one-year return on the share class's Morningstar category (net of expenses) for each year from 2008 through 2014. The results are then placed into bins and plotted by summing each share class's gross sales in each prior year as a percentage of gross sales over the entire 2007–2013 period. The analysis includes equity, balanced, and bond mutual funds with at least one share class with a front-end load, excluding mutual funds available as investment choices in variable annuities and mutual funds that invest primarily in other mutual funds.

Sources: Investment Company Institute and Morningstar

Some academic studies seek to measure the outcomes of investors using brokers by comparing returns on broker-sold funds with those of no-load or direct-sold funds,<sup>32</sup> under the assumption that no-load or direct-sold funds capture how investors using broker-sold funds might perform if their brokers could use funds outside the broker-sold universe.

On a three-year relative return, the difference in returns between front-end load and retail no-load share classes is 27 basis points (*see* Figure 3).<sup>33</sup> Some of this difference is accounted for by 12b-1 fees, which compensate brokers and their firms for the services that they provide to their clients. Investors would have to pay for such services whether they used a broker or a financial adviser that was an ERISA fiduciary. When 12b-1 fees are added back to measure the performance before compensating the brokers and their firms, the difference in returns between front-end load funds and retail no-load funds drops to 6 basis points on a sales-weighted average and 7 basis points on an asset-weighted

<sup>32</sup> Direct-sold funds are funds sold *directly* by a fund company, in contrast to funds that are sold *indirectly* by intermediaries to a fund company—like brokers.

<sup>33</sup> *See* RIA Letter, Figure 4 and accompanying text, at pp. 20–21.

average. These differences are less than one-tenth the 100 basis point “underperformance” that the RIA asserts.<sup>34</sup>

**Figure 3**  
**Three-Year Returns on Front-End Load Share Classes and Retail No-Load Share Classes Relative to Their Morningstar Category Returns**  
*Percent; selected periods*

Year	ICI sales-weighted average		Morningstar asset-weighted average	
	Front-end load	Retail no-load	Front-end load	Retail no-load
2007	-0.09	-0.03	0.20	0.45
2008	0.07	0.56	0.07	0.56
2009	0.14	0.33	0.23	0.55
2010	0.39	0.62	0.62	0.77
2011	0.41	0.70	0.67	0.88
<i>Average:</i>				
2007–2011	0.17	0.44	0.37	0.65
Memo: Sales- and asset-weighted 12b-1 fee over given period				
2007–2011	0.23	0.03	0.23	0.02

Note: The relative return is calculated by taking the three-year return of a share class of a fund (net of expenses) less the three-year return on the share class's Morningstar category (net of expenses) for each year from 2010 through 2014. These relative returns are then matched to their three-year prior gross sales or assets. For example, the 2007 sales-weighted averages report the three-year relative return for the period 2008–2010 weighted by gross sales in 2007. The analysis includes equity, balanced, and bond mutual funds with at least one share class with a front-end load, excluding mutual funds available as investment choices in variable annuities and mutual funds that invest primarily in other mutual funds.

Sources: Investment Company Institute and Morningstar

## **2. Data also show that investors concentrate their purchases in front-end load share classes with lower expense ratios and that pay brokers lower-than-average loads.**

There is further evidence that brokers do not systematically steer their clients to poor-performing funds with higher loads or fees. We examined data from Strategic Insight Simfund, which contains N-SAR data from 2010 to 2013 showing loads paid to brokers, measured as a percentage of total fund sales subject to a load.<sup>35</sup> If brokers are skewing investors to funds that pay the brokers higher loads, then we should expect sales-weighted average loads to be higher than the simple average load paid.

<sup>34</sup> Using a three-year relative return introduces a small survivorship bias because some share classes are in the one-year returns but not in the three-year returns. On average, 1.6 percent of the front-end load sales in each year have no three-year return and 2.0 percent of retail no-load sales, on average, have no three-year return.

<sup>35</sup> See RIA Letter, Figure 6 and accompanying text, at pp. 22–23.

Instead, for each fund investment group, the sales-weighted average load paid to brokers is less than the simple average load paid. These data on loads contradict the notion that brokers are systematically steering their clients to funds that pay above-average loads.

**3. Sales of front-end load share classes are skewed toward those with below-average expense ratios—further contradicting the notion that brokers systemically are not acting in the best interests of their clients.**

Fund expense data also show strong market forces at work driving investors to funds with below-average expenses. Sales of front-end load share classes are skewed to those with below-average expense ratios, measured as either the total expense ratio (which includes the 12b-1 fee) or the fund expenses used to operate the fund (the total expense ratio minus the 12b-1 fee). Sales-weighted and asset-weighted expense ratios for front-end load share classes are below the simple average total expense ratios or operating expense ratios for front-end load share classes.<sup>36</sup>

Investors in front-end load share classes are paying fund expenses that are in line with retail no-load share classes. Sales-weighted and asset-weighted expense ratios are higher for front-end load share classes than for retail no-load share classes, but a large portion of the difference is that expenses of front-end load share classes include 12b-1 fees used to pay brokers or intermediaries for their services. Focusing on the expenses used to operate the fund (“operating expense ratios”), investors in front-end load share classes generally are paying operating expenses near what investors in retail no-load share classes are paying. And the asset-weighted and sales-weighted operating expense ratios for front-end load share classes are below the simple average operating expenses charged by the average retail no-load share class in all but one case (the sales-weighted taxable bond). These figures undermine the Department’s contention that investors “pay insufficient attention to expenses.”<sup>37</sup>

In conclusion, our analysis shows that the experience of investors in front-end load funds since 2007 is dramatically different from the RIA’s description of the experience of investors using front-end load funds. We find no evidence to support the RIA’s assertion that there is a “substantial failure of the market.”<sup>38</sup> Furthermore, as we discuss below, the RIA overstates the benefits of the Department’s proposal by failing to consider all of its costs. Under the proposal’s current design, investors with small balances could potentially pay more for their services from financial advisers, be shut out of the advice market, or be faced with much larger switching costs. In fact, the net impact of the fiduciary proposal as it is currently designed could be negative for many IRA investors.

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<sup>36</sup> See RIA Letter, Figure 7 and accompanying text, at pp. 23–25.

<sup>37</sup> See RIA at p. 97.

<sup>38</sup> See RIA at pp. 3, 7, and 211.

### C. The RIA Ignores the Economic Impact of Moving Investors to Fee-Based Accounts

The Department's evaluation of the impact of the fiduciary proposal focuses solely on the costs of advice and assistance paid through a fund—pursuant to an up-front sales charge and 12b-1 fees, for example. But the Department fails to consider how these costs compare to the costs that investors incur when they pay a financial adviser directly for advice (for example, using an asset-based fee that an investor pays directly to a financial adviser) rather than paying through a fund with a front-end load or a 12b-1 fee. In doing so, the Department exaggerates the benefits from lower loads resulting from its proposal and ignores possible costs that investors could incur if they move to fee-based advice.

The RIA calculates that IRA investors currently pay between 26 and 28 basis points per year in front-end loads, in addition to fund expenses. Most front-end load funds have a 12b-1 fee which also is used to compensate the broker and the brokerage firm for their services. The average 12b-1 fee for front-end load funds, on an asset-weighted basis, is about 24 basis points. Adding together both the annualized load costs of 26 to 28 basis points and the 12b-1 fees, the total annual cost for the services provided by brokers and their firms to investors in front-end load funds is about 50 basis points a year.

The Department predicts that its BIC Exemption will induce brokers to reduce loads substantially over 20 years.<sup>39</sup> As the Institute points out in its comment letters, the BIC Exemption is unworkable; even if it could work, it would impose prohibitive costs on brokers. Brokers subject to the Exemption's many new limitations, burdens, and costs, as well as its increased exposure to liability, are likely to seek to move many of their clients to fee-based accounts. Such accounts, however, require much greater level of time and engagement through frequent rebalancing of investors' accounts—a level of service that is unnecessary for an investor with a modest balance who is typically better off as a buy-and-hold investor. This additional ongoing engagement results in higher and ongoing expense for the investor.

A recent study by Cerulli Associates finds that fee-based accounts—the most likely alternative to brokerage accounts—cost investors 111 basis points per year on average, in addition to fund expenses.<sup>40</sup> As detailed in ICI's comment letter to the Department of Labor, it is reasonable to assume that many IRA investors with larger balances will migrate to fee-based advisers and thus pay more. Even allowing for an increase in performance equal to that of investors in no-load funds relative to broker-sold funds over the past few years, if all IRA investors in broker-sold funds with balances of at least \$100,000 migrate to fee-based accounts, we estimate that they will pay higher fees and thus earn lower returns totaling \$47 billion over 10 years.

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<sup>39</sup> See RIA at p. 113.

<sup>40</sup> See Cerulli Associates, Inc., *Cerulli Report RIA [Registered Investment Advisor] Marketplace 2014* at p. 20. The average asset-based fee includes high-net worth accounts, which typically are charged lower asset-based fees. Accounts of average or smaller size may pay higher fees.



#### **D. The RIA Fails to Account for the Societal Harm of Investors Losing Access to Advice and Guidance**

In its estimates of the cost of its proposed rule, the Department focuses only on administrative or compliance costs. It does not measure any harm that can occur if it adopts the proposed rule—including the risk that at least some retirement savers could lose access to advice and information they currently rely on to meet their savings goals.

If the problems with the proposed fiduciary definition and the BIC Exemption are not addressed, significant numbers of investors can be expected to lose access to the guidance, products, and services that they currently receive from brokers. Financial advisers, regardless of their standard of care, are unlikely to work in an environment of greater costs, limitations, and exposures to liability for less compensation. Indeed, many broker-dealers are likely to exit the market for retirement advice under the proposed rule. The Department thus ignores the impact of its proposed rule on the quality and appropriateness of investment choices that retirement savers must make.

ICI research finds that IRA investors rely on financial professionals to assist with rollovers, creating a retirement strategy, and determining withdrawal amounts.<sup>41</sup> We also find a positive correlation between investors' use of financial professionals and investors' willingness to take financial risk.<sup>42</sup> Indeed, in its justification of an earlier rule change, the Department said that retirement investors who do not receive investment advice are twice as likely to make poor investment choices as those who do receive that advice.<sup>43</sup> The benefits of advice—and, conversely, the harm of losing access to advice—are significant.

Retirement investors may be left with no choice but to seek asset-based fee accounts to obtain the investment assistance that they need. But as we have already established, the cost of investing through those accounts can be greater—not less—than the cost of investing with brokers.

Moreover, fee-based accounts may not be available to low- and middle-income IRA investors who cannot meet minimum account balance requirements. Currently, fee-based advisers often require minimum account balances of \$100,000 because, even with a 1 percent fee, accounts with fewer assets generate too little income to make the provision of ongoing advice profitable. Significantly, 22.2 million U.S. households hold IRA assets of less than \$100,000, and low- and middle-income households are more likely to have IRA balances below \$100,000, as shown in Figure 4.

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<sup>41</sup> See Sarah Holden and Daniel Schrass, "The Role of IRAs in U.S. Households' Saving for Retirement, 2014," *ICI Research Perspective* 21, no. 1 (January 2015), available at [www.ici.org/pdf/per21-01.pdf](http://www.ici.org/pdf/per21-01.pdf).

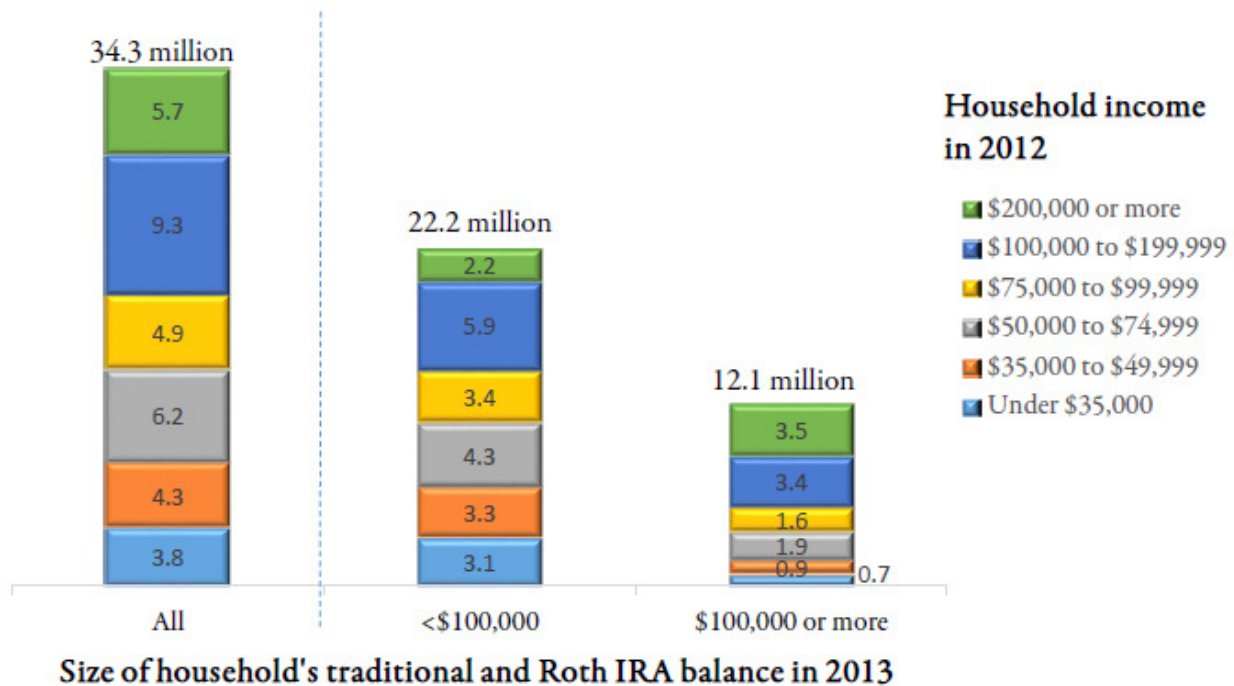
<sup>42</sup> See Daniel Schrass, "Ownership of Mutual Funds Through Investment Professionals, 2012," *ICI Research Perspective* 19, no. 2 (February 2013), available at [www.ici.org/pdf/per19-02.pdf](http://www.ici.org/pdf/per19-02.pdf)

<sup>43</sup> See Investment Advice—Final Rule. 76 Fed. Reg. 66136, 66152 (October 25, 2011).

**Figure 4**

**22.2 Million Households Have IRA Balances Less Than \$100,000**

*Millions of households by household income and household IRA balances*



Note: In 2013, 22.2 million, or 65 percent of, households with traditional or Roth IRAs had balances of less than \$100,000, and 12.1 million, or 35 percent, had balances of \$100,000 or more. Components may not add to 100 percent because of rounding.

Source: Investment Company Institute tabulation of Federal Reserve Board 2013 Survey of Consumer Finances

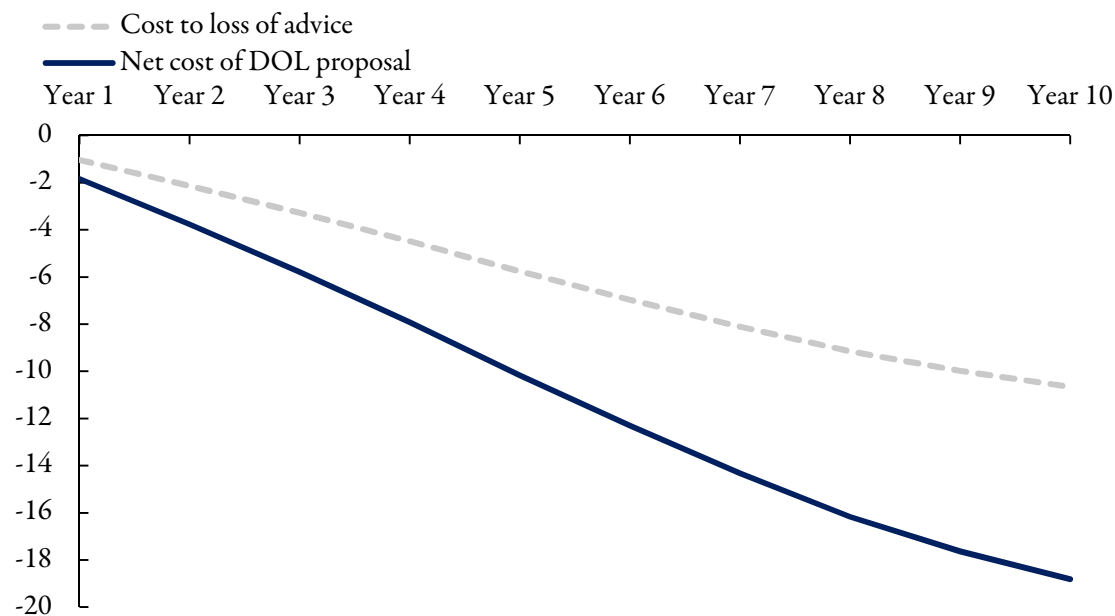
Other market participants may seek to overcome the proposed rule's barriers and find ways to serve retirement savers who now rely on broker-dealers. It is entirely foreseeable, however, that many IRA investors would no longer be able to obtain advice under the proposed rule. If these investors, over time, lose access to advice and service, their accounts are likely to earn lower returns in the future. These lower returns could occur, for example, through poor asset allocation decisions, poorly timed investment decisions, penalties for early withdrawals, or incorrectly calculated required minimum distributions. Even if these individuals no longer have to pay for services, the net loss on their accounts would have a negative impact.

Assuming that investors with less than \$100,000 in IRA balances no longer have access to advice because the BIC Exemption is not workable, then over time these investors are likely to experience lower returns because of poor asset allocation and market timing, or because they incurred tax penalties by taking early withdrawals. Factoring in the lower performance for these investors, and adding to the additional costs for the other 81 percent of IRA assets that would shift to fee-based

accounts, it is possible that the net loss from the proposal, if adopted, could impose annual losses to investors amounting to nearly \$19 billion a year within 10 years (Figure 5).

**Figure 5**  
**Annual Effect on Investors If They Lose Access to Financial Advice**

*Billions of dollars a year*



Source: Investment Company Institute

The losses that investors would likely incur under the Department’s proposal stand in stark contrast to the benefits that the CEA and the Department claim. The reason that the CEA and the Department can claim that the proposal would have a net benefit to investors is that their analysis shares several common errors, including: (a) overestimate of the “underperformance” of broker-sold funds; (b) misapplication of the academic research underlying the estimates; (c) failure to acknowledge the added costs borne by investors forced to move from commission-based to fee-based accounts; and (d) failure to acknowledge lost returns suffered by investors with small accounts who forego advice altogether due to loss of the commission-based option.

Correcting for these errors and omissions, we find significant net costs to investors, whether calculated on an annual basis using the CEA’s methods or for the first 10 years after implementation by the Department’s methods. Indeed, correcting for the Department’s many errors and omissions, we find that the Department’s proposal, if adopted, will result in net losses to investors of \$109 billion over 10 years.

We are, of course, unable to quantify other significant potential costs resulting from the Department’s proposed rules. As we discuss above and in our comment letters, the consequence of an expansive and ambiguous fiduciary definition combined with an unworkable BIC Exemption will be that investors—particularly investors with small account balances—will find significant barriers for

seeking out advice and assistance, even outside the broker market. Increasing information barriers and transaction costs certainly would reduce the ability of IRA investors to move from one adviser to another or from one fund provider to another, further harming investors.

#### **E. The RIA Fails to Meet the Minimum Standards Applicable to Agency Rulemaking**

The Department's meager attention to the potential harm to investors resulting from its rule proposal is surprising given the proposal's likely impact on retirement savers. To meet even the minimum standards required of an agency rulemaking of this nature,<sup>44</sup> the RIA at a minimum should have included information derived from quantitative or qualitative data focused more clearly on showing the problem that the proposal is intended to solve, as well as the anticipated costs and benefits of the proposal as a solution.

The Department fails to provide supportable data and other information describing the nature and magnitude of the *costs* arising from persons and financial services firms with alleged potential conflicts. Consistent with its regulatory obligations, however, the Department also should have provided data and other information on the *benefits* stemming directly or indirectly from the services provided by these persons and financial services firms. For example, given the Department's identification of front-end loads or the receipt of 12b-1 fees as creating a potential conflict, it should have identified and analyzed the benefits to investors of advice or information provided to them by the broker-dealers who receive those fees (for example, through the greater availability of guidance, diverse product offerings, educational tools, and information generally). Wrong on the costs and silent on the benefits, the RIA falls far short of what retirement savers and Congress have a right to expect from the Department.

### **IV. CHANGES IN RETIREMENT POLICY SHOULD BEGIN WITH AN ASSESSMENT OF THE EXISTING SYSTEM AND BUILD UPON ITS STRENGTHS AND SUCCESSES**

Even with its many current strengths, the U.S. retirement system can be strengthened further to help even more Americans achieve a secure retirement. The Institute supports policies that would

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<sup>44</sup> Executive Order 12866 (*see* 58 Fed. Reg. 51735 (October 4, 1993)), as reaffirmed by the Administration in January 2011, pursuant to Executive Order 13563 (*see* 76 Fed. Reg. 3821 (January 21, 2011)), is well understood to govern the rulemaking process. The Department states in the preamble to the Proposed Fiduciary Rule that the Office of Management and Budget has determined that the proposed rule is economically significant within the meaning of section 3(f)(1) of Executive Order 12866, because it likely would have an effect on the economy of \$100 million in at least one year. *See* Fiduciary Rule Notice at 21951. As the Proposed Fiduciary Rule is a "significant" regulatory action, the Department is required to include, within its RIA: (i) an assessment, including the underlying analysis, of the benefits anticipated from the regulatory action; (ii) an assessment, including the underlying analysis, of the costs anticipated from the regulatory action; and (iii) an assessment, including the underlying analysis, of costs and benefits of potentially effective and reasonably feasible alternatives to the planned regulation, and an explanation why the planned regulatory action is preferable to the identified potential alternatives. *See* Executive Order 12866, section 6(a)(3)(C).

improve access to retirement savings opportunities and make retirement plans more efficient and effective. These improvements would build upon the strengths of the current system. Unfortunately, as is the case with the Department’s fiduciary proposal, there are many who promote drastic reforms without analyzing the actual need for such changes or the impact they will have on the very people they seek to help.

Any examination of reforms designed to improve the retirement system should begin with an assessment of Americans’ retirement prospects and the role that the current system plays in helping American workers reach their retirement goals. The Institute believes that a careful examination of the facts will lead this Subcommittee to continue its support for policies that protect the national voluntary retirement system and scrutinize with some caution the prospect of an ever-expanding patchwork of 50 state-run plans for private-sector employees.

#### **A. The U.S. Retirement System Is Helping Millions of Americans Achieve a Secure Retirement**

Retirement policy discussions often start from the premise that retirees’ pension income has fallen over time. Contrary to this conventional wisdom, private-sector pension income has become more prevalent and more substantial—not less prevalent or less substantial—over time. Since the enactment of ERISA, increasing numbers of retirees receive benefits from private-sector pension plans (DB and DC) and receive more in benefits from these plans:

- Data from the Current Population Survey (CPS) show the share of retirees receiving private-sector pension income increased by more than 60 percent between 1975 and 1991, and has remained fairly stable since.<sup>45</sup>
- Among those receiving income from private-sector pensions, the median amount of inflation-adjusted income—which had remained fairly flat between 1975 and 1991—increased by more than 40 percent between 1991 and 2013.<sup>46</sup>

Other evidence indicates that retirees have become better off over time.

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<sup>45</sup> In 1975, the median per capita pension benefit for the 20 percent of retirees with pension income only from private-sector pensions was about \$4,900 per year in constant 2013 dollars. See Brady and Bogdan, “A Look at Private-Sector Retirement Plan Income After ERISA, 2013,” *ICI Research Perspective* 20, no. 7 (October 2014), available at [www.ici.org/pdf/per20-07.pdf](http://www.ici.org/pdf/per20-07.pdf). Recent efforts by the CPS to improve the collection of retiree income information have further increased the share of retirees with private-sector pension income and the amount of that income (based on ICI tabulation of the recently released March 2015 CPS data).

<sup>46</sup> *Id.* (Figure 7 and Table 19 in the supplemental tables). The increase in pension income since ERISA is likely understated because the survey data used to analyze retiree income do not fully capture payments from DC plans and IRAs. See also Figure 20 and discussion, pp. 20–22, in Sabelhaus and Schrass, “The Evolving Role of IRAs in U.S. Retirement Planning,” *Investment Company Institute Perspective* 15, no. 3 (November 2009), available at [www.ici.org/pdf/per15-03.pdf](http://www.ici.org/pdf/per15-03.pdf).

- Poverty rates for people aged 65 or older have fallen. In 1966, the elderly poverty rate was nearly 30 percent. In 2014, it was 10 percent—and the elderly had the lowest poverty rate among all age groups.<sup>47</sup>
- Academic analysis has found that successive generations have reached retirement wealthier than the last.<sup>48</sup>
- Assets specifically earmarked for retirement have increased significantly. Adjusted for inflation and population growth, retirement assets at year-end 2014 were more than seven times the level at year-end 1975.<sup>49</sup>
- Asset accumulation in defined contribution (DC) plans compares favorably with that in defined benefit plans.<sup>50</sup>

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<sup>47</sup> See Figure 5 in U.S. Census Bureau, “Income and Poverty in the United States: 2014,” *Current Population Reports*, no. P60-252 (September 2015), available at [www.census.gov/content/dam/Census/library/publications/2015/demo/p60-252.pdf](http://www.census.gov/content/dam/Census/library/publications/2015/demo/p60-252.pdf). In 2014, the poverty rate for individuals aged 18 to 64 was 14 percent, while it was 21 percent for those younger than 18.

<sup>48</sup> See Haveman, Holden, Wolfe, and Romanov, “The Sufficiency of Retirement Savings: Comparing Cohorts at the Time of Retirement,” *Redefining Retirement: How Will Boomers Fare?* Edited by Madrian, Mitchell, and Soldo: pp. 36–69, New York: Oxford University Press (2007); and Gustman, Steinmeier, and Tabatabai, “How Do Pension Changes Affect Retirement Preparedness? The Trend to Defined Contribution Plans and the Vulnerability of the Retirement Age Population to the Stock Market Decline of 2008–2009,” *Michigan Retirement Research Center Working Paper 2009-206* (October 2009), available at [www.mrrc.isr.umich.edu/publications/papers/pdf/wp206.pdf](http://www.mrrc.isr.umich.edu/publications/papers/pdf/wp206.pdf).

<sup>49</sup> See Brady, Burham, and Holden, *The Success of the U.S. Retirement System*, Figure 4, p. 11 (updated to year-end 2014), available at [www.ici.org/pdf/ppr\\_12\\_success\\_retirement.pdf](http://www.ici.org/pdf/ppr_12_success_retirement.pdf).

<sup>50</sup> Taking into account the risks faced by retirement plan participants—for example, the investment risk faced by workers in DC plans and the job turnover risk faced by workers in DB plans—several studies have concluded that the majority of workers who only have access to DC plans during their working careers will be better off than if they only had access to DB plans. For example, Samwick and Skinner (2004) analyze SCF data that provide detailed plan descriptions for a representative sample of DB plans and DC plans. Comparing typical DB plans with typical 401(k) plans under a variety of possible labor market and investment return scenarios, the authors concluded that “generally, 401(k) plans ... are as good or better than DB plans in providing for retirement.” Schragger (2009) uses data from the Panel Study of Income Dynamics (PSID) to model four sources of uncertainty: wage growth, job turnover, asset returns, and life expectancy. Comparing DC plans and DB plans that are of equal cost to the employer, the author concludes that, by the 1990s, DC plans were preferred by most workers. Poterba et al. (2007) analyze HRS data that include both detailed descriptions of retirement plans and the actual work histories of individuals. The authors project that retirement resources will be higher on average with private-sector DC plans than they would be with private-sector DB plans.

See Samwick and Skinner, “How Will 401(k) Pension Plans Affect Retirement Income?” *The American Economic Review* 94, no. 1 (March 2004): 329–343; Schragger, “The Decline of Defined Benefit Plans and Job Tenure,” *Journal of Pension Economics and Finance* 8, no. 3 (July 2009): 259–290; and Poterba, Rauh, Venti, and Wise, “Defined Contribution Plans, Defined Benefit Plans, and the Accumulation of Retirement Wealth,” *Journal of Public Economics* 91, no. 10 (November 2007): 2062–2086.

These statistics speak to the impact of the combined changes implemented over many years, with the increased generosity of Social Security benefits, the enactment of ERISA in 1974, the creation of the 401(k) plan in 1978,<sup>51</sup> the Economic Growth Tax Relief Reconciliation Act (EGTRRA) in 2001, the Pension Protection Act (PPA) in 2006, and other measures. A crucial foundation of this success is the voluntary employer-sponsored retirement plan system, built around the laws and regulations that allow deferral of tax on compensation set aside for retirement. Rules allowing tax-deferred compensation date back to the origin of the income tax,<sup>52</sup> and play a crucial role in encouraging employers to establish and maintain retirement plans for their workers.

As discussed below, however, even with its many successes, the U.S. retirement system can be strengthened further to help even more Americans achieve a secure retirement.

## **B. The Composition of Resources Relied Upon in Retirement Differs from Household to Household**

Assessing whether or not workers are saving enough for retirement requires a standard by which to judge savings adequacy. Retirement savings adequacy typically is defined in relative, rather than absolute, terms: savings would be judged adequate if the savings allowed retired households to maintain the standard of living they enjoyed while working. It is difficult to judge adequacy early in a worker's career because the focus on dedicated retirement savings typically occurs later in a working career. Younger households typically have other savings goals that compete with retirement savings, such as funding education, purchasing a home, and building a rainy-day fund. Importantly, this life-cycle pattern of savings observed in the data is consistent with rational economic behavior. Because of this change in focus over the life cycle, it is difficult to assess retirement preparedness for households that are not in or near retirement.

In assessing whether American workers are saving enough for retirement, it is also important to understand the different resources that most people will draw upon in retirement and the role that each resource plays. The traditional analogy is that retirement resources are like a three-legged stool. This analogy implies that everyone should have resources divided equally among Social Security, employer-sponsored pension plans, and private savings. This is not an accurate picture of Americans' retirement resources—nor has it ever been. Retirement resources are better represented as a pyramid (*see* Figure 6). The retirement resource pyramid has five basic components: Social Security; homeownership; employer-sponsored retirement plans (both private-sector employer and government employer plans, including both DB and DC plans); IRAs (including contributory and rollover accounts); and other

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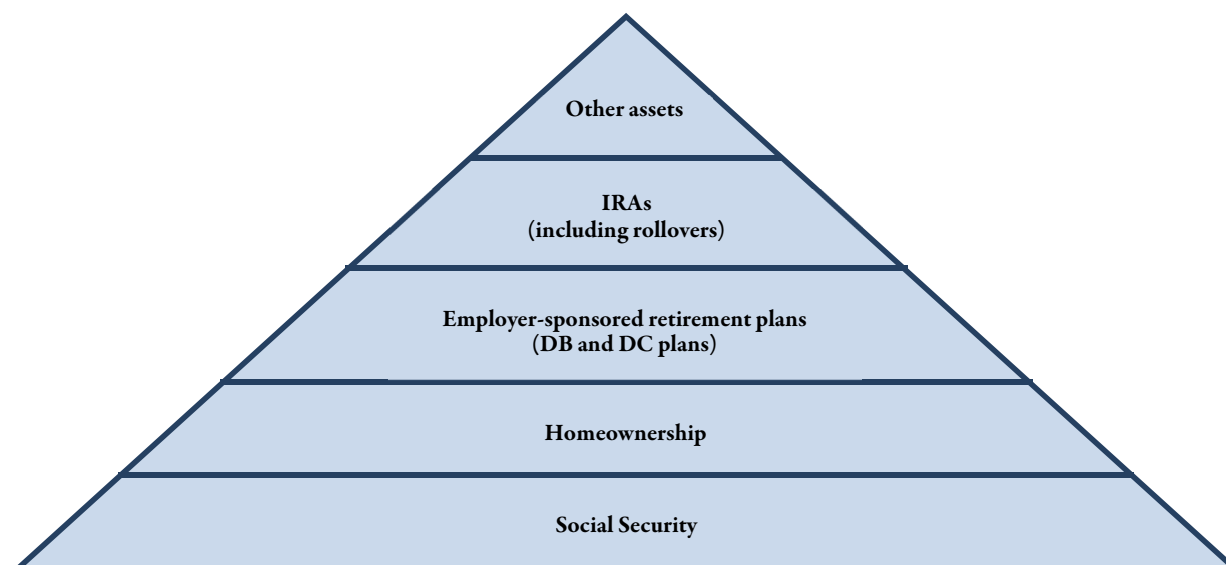
<sup>51</sup> Although Congress added section 401(k) to the Internal Revenue Code with the Revenue Act of 1978, it was not until November 10, 1981 that the Internal Revenue Service (IRS) formally described the rules for these plans. *See* discussion pp. 1–4 in Holden, Brady, and Hadley, “401(k) Plans: A 25-Year Retrospective,” *Investment Company Institute Research Perspective* 12, no. 2 (November 2006), available at [www.ici.org/pdf/per12-02.pdf](http://www.ici.org/pdf/per12-02.pdf).

<sup>52</sup> The modern federal income tax was established in 1913. The deferral of tax on contributions to profit-sharing plans was codified in the Revenue Act of 1921, and deferral of tax on contributions to DB plans was added in the Revenue Act of 1926. The earlier statutory text is vague as to what forms of compensation represent current income, so it is not clear how deferred compensation was treated before these laws were enacted.

assets.<sup>53</sup> The composition of the retirement resource pyramid—that is, the extent to which a household relies on any given resource—will differ from household to household.

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**Figure 6**  
**Retirement Resource Pyramid**



Source: Investment Company Institute; see Brady, Burham, and Holden, *The Success of the U.S. Retirement System* (December 2012)

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It is possible to estimate the retirement resource pyramid for U.S. households, but doing so requires measuring the value of a household’s future stream of Social Security and DB plan benefits. Gustman, Steinmeier, and Tabatabai (2009) undertook this exercise using data from the Health and Retirement Study (HRS).<sup>54</sup> The analysis focuses on households approaching retirement—in this case, households with a member born between 1948 and 1953 (aged 57 to 62 in 2010). Their analysis is used to estimate the components of the retirement resource pyramid for these households, with households grouped by their augmented wealth (see Figure 7). Reflecting Social Security’s progressive benefit

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<sup>53</sup> These assets can be financial assets—including bank deposits and stocks, bonds, and mutual funds owned outside of employer-sponsored retirement plans and IRAs—and nonfinancial assets—including business equity, nonresidential property, second homes, vehicles, and consumer durables (long-lived goods such as household appliances and furniture). Assets in this category tend to be owned more frequently by higher-income households. For a more complete discussion of the retirement resource pyramid, see Brady, Burham, and Holden, *The Success of the U.S. Retirement System*, Investment Company Institute (December 2012).

<sup>54</sup> See Gustman, Steinmeier, and Tabatabai, “How Do Pension Changes Affect Retirement Preparedness? The Trend to Defined Contribution Plans and the Vulnerability of the Retirement Age Population to the Stock Market Decline of 2008–2009,” *University of Michigan Retirement Research Center Working Paper* 2009-206 (October 2009). The paper used 2006 HRS data, and the authors provided updated data from the 2010 HRS, which are presented in Figure 7.



formula, households approaching retirement in the lowest augmented wealth quintile (the lowest 20 percent) rely heavily on Social Security benefits. In 2010, Social Security comprised 80 percent of total augmented wealth for those households. Even with Social Security replacing a high percentage of earnings for these households, many also had equity in their homes, accumulated retirement benefits, and other assets.

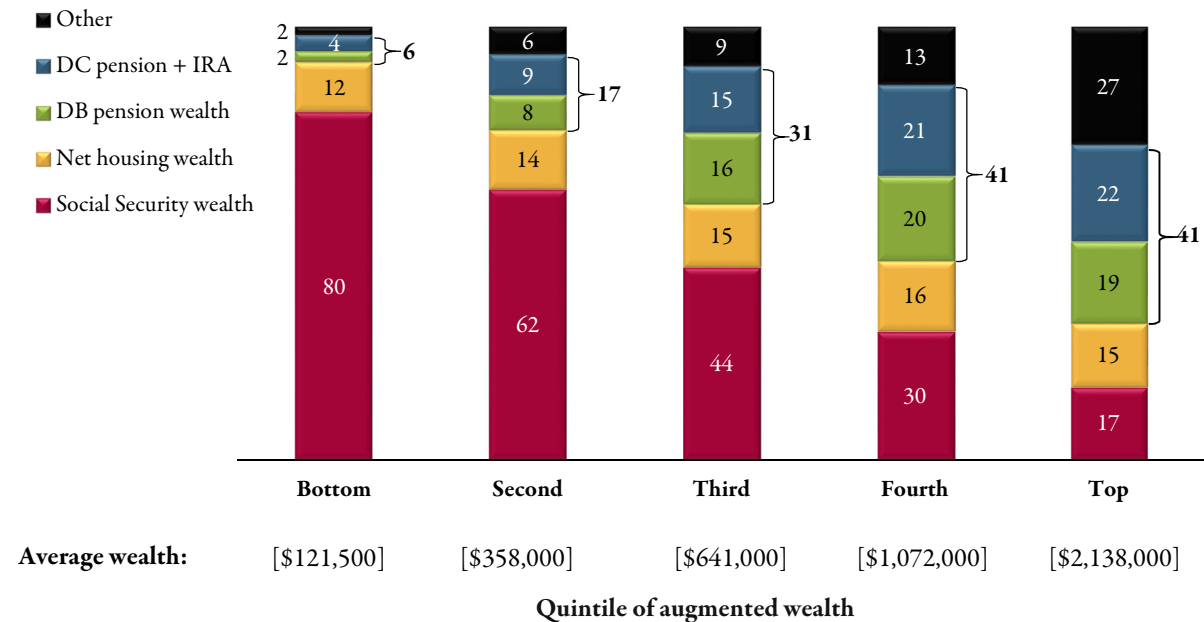
In comparison with those with lower augmented wealth, households approaching retirement in the middle of the augmented wealth distribution rely more heavily on resources other than Social Security. Social Security comprised a large portion of total augmented wealth (44 percent) for households approaching retirement in the middle of the augmented wealth distribution (*see* Figure 7). For this group, equity in their homes made up 15 percent of augmented wealth and the combination of employer-sponsored DB and DC retirement plans and IRAs comprised another 31 percent of augmented wealth. Thus, in the middle of the augmented wealth distribution, households draw more than half of their retirement resources from employer-sponsored retirement plans and IRAs, equity in their homes, and other assets.

The highest augmented wealth quintile of households approaching retirement relies relatively little on Social Security, reflecting the fact that Social Security benefits typically replace a much smaller share of lifetime earnings for this group. For these households, employer-sponsored retirement plans, IRAs, and other assets are more important. For households approaching retirement in the top augmented wealth quintile, Social Security comprised only 17 percent of total augmented wealth (*see* Figure 7). For this group, 22 percent of total augmented wealth was composed of employer-sponsored DC plans and IRAs, 19 percent from DB plans, 15 percent from equity in their homes, and 27 percent from other assets.

**Figure 7**

**Retirement Resource Pyramid Varies with Wealth**

*Percentage of wealth by wealth quintile, households with at least one member age 57 to 62, excludes top and bottom one percent, 2010*



Source: Investment Company Institute tabulation derived from an updated Table 3 of Gustman, Steinmeier, and Tabatabai (2009) using Health and Retirement Study (HRS) data

**1. Social Security**

Retirement policy discussions often ignore the fact that the United States already has a mandatory retirement plan: Social Security. Social Security stands as the broad base of the retirement resource pyramid, providing households across all levels of earnings with inflation-indexed income for life. For most households, Social Security is one of their most valuable resources.

When Social Security was signed into law in 1935, it was intended to replace a modest portion of income. Changes to the system since its inception—in particular, two periods of expansion, first in the 1950s and then again in the 1970s—increased benefits substantially, especially for those with low lifetime earnings.<sup>55</sup> Described as a “cornerstone” for U.S. retirement security at its beginning, Social Security has transformed into a comprehensive government-provided pension for workers with lower

<sup>55</sup> See Brady, Burham, and Holden, *The Success of the U.S. Retirement System*, Investment Company Institute (December 2012), at pp. 17–20.

lifetime earnings and a strong foundation for retirement security for those with higher lifetime earnings.

The expansion of benefits has not come without costs. In 1937, the OASDI tax rate was 2.0 percent on up to \$3,000 of wages and salary (equivalent to about \$49,000 in constant 2015 dollars). Today, Social Security mandates contributions for American workers of 12.4 percent of wages and salary from the first dollar they earn up to the maximum annual earnings covered by the system, *i.e.*, \$118,500 in 2015.<sup>56</sup>

Social Security benefits are designed to be progressive; that is, the benefits represent a higher proportion of pre-retirement earnings for workers with lower lifetime earnings than for workers with higher lifetime earnings. For example, for the cohort of individuals born in the 1960s who claim benefits at age 65, Congressional Budget Office (CBO) analysis shows that Social Security benefits are projected to replace 69 percent of average wage-indexed earnings for the typical individual in the lowest-earning 20 percent of households ranked by lifetime earnings (*see* Figure 8, left panel).<sup>57</sup> The replacement rate falls to 44 percent for individuals in the middle 20 percent of households and 27 percent for individuals in the highest 20 percent of households, ranked by lifetime earnings.

These statistics, however, understate the generosity of Social Security benefits. As explained in a recent paper by Pang and Schieber, traditional replacement rate measures used by both the CBO and the Social Security Administration (SSA) measure Social Security benefits as a percentage of *wage-indexed* lifetime earnings.<sup>58</sup> If a worker is seeking to maintain their standard of living in retirement, *inflation-indexed*, not wage-indexed, earnings represent a better metric of success. Because wages have grown more quickly than inflation over time, Social Security benefits replace a higher percentage of inflation-indexed earnings.

This can be illustrated using CBO projected replacement rates, which, for the first time in December 2014, reported Social Security replacement rates for both wage-indexed earnings and inflation-indexed earnings. For workers born in the 1960s who claim benefits at age 65, CBO projects

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<sup>56</sup> See Social Security Administration, "Contribution and Benefit Base Determination," available at [www.ssa.gov/oact/cola/cbbdet.html](http://www.ssa.gov/oact/cola/cbbdet.html). For historical tax rates, *see* [www.ssa.gov/oact/progdata/taxRates.html](http://www.ssa.gov/oact/progdata/taxRates.html). For the historical earnings base, *see* [www.ssa.gov/oact/COIA/cbb.html](http://www.ssa.gov/oact/COIA/cbb.html). OASDI taxes as a percentage of earnings increased to 3.0 percent by 1950, to 6.0 percent by 1960, to 8.4 percent by 1970, to 10.16 percent by 1980, and reached the current 12.4 percent rate in 1990.

<sup>57</sup> See Congressional Budget Office, *The 2014 Long-Term Projections for Social Security: Additional Information* (December 2014), available at [www.cbo.gov/publication/49795](http://www.cbo.gov/publication/49795).

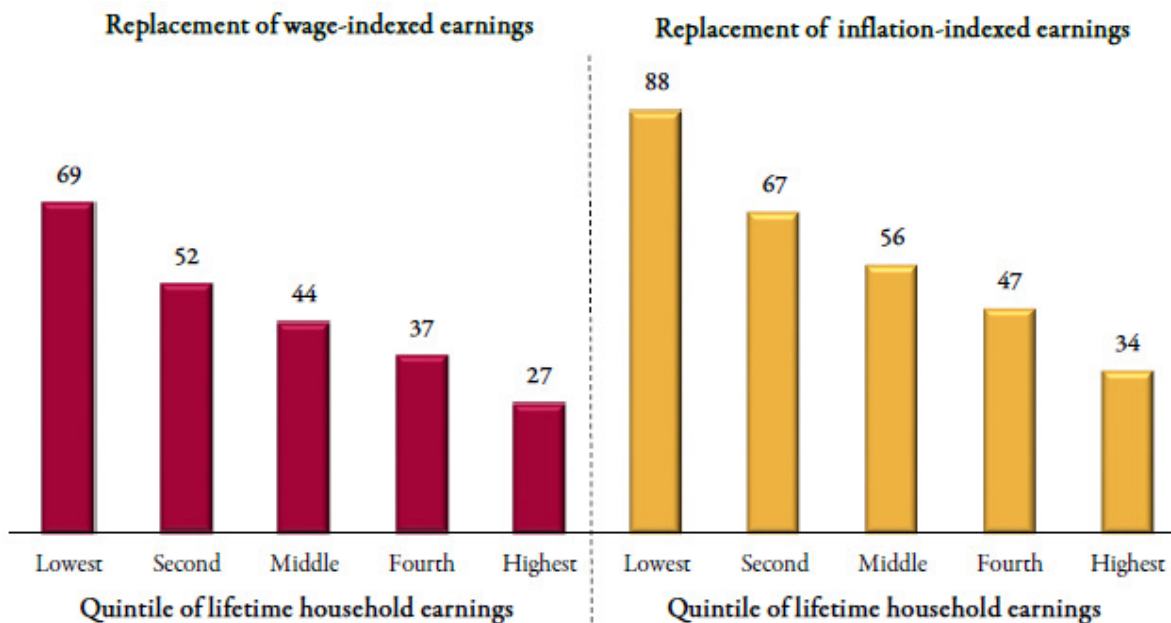
<sup>58</sup> See Pang and Schieber, "Why American Workers' Retirement Income Security Prospects Look so Bleak: A Review of Recent Assessments," *Working Paper* (May 31, 2014), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2433193](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2433193).

that Social Security benefits will replace, on average, 88 percent of inflation-indexed lifetime earnings for individuals in the lowest-earning 20 percent of households, 56 percent for individuals in the middle 20 percent, and 34 percent of individuals in the highest 20 percent (see Figure 8, right panel).

**Figure 8**

**Generosity of Social Security Benefits Is Typically Understated**

*Average replacement rates for workers claiming at age 65 by household lifetime earnings, 1960s birth cohort, percent*



Note: Replacement rates are calculated as the ratio of Social Security benefits to average lifetime earnings for each worker. Source: Congressional Budget Office, *The 2014 Long-Term Projections for Social Security: Additional Information*

Even the replacement rates of inflation-indexed earnings published by CBO understate the generosity of the Social Security system as it was designed to work. CBO presents replacement rates for workers who claim benefits at age 65. For individuals born in 1960 or later, the full benefit retirement age is 67. For every month that claiming is delayed, Social Security benefits are increased. If workers delayed claiming benefits until age 67, Social Security benefits would increase by approximately 15.3 percent (see Figure 9). For the typical individual in the lowest-earning 20 percent of households, Social Security benefits would more than replace average inflation-indexed lifetime earnings if claimed at age 67, and the average replacement rate would increase to 65 percent for workers in the middle 20 percent of households.<sup>59</sup>

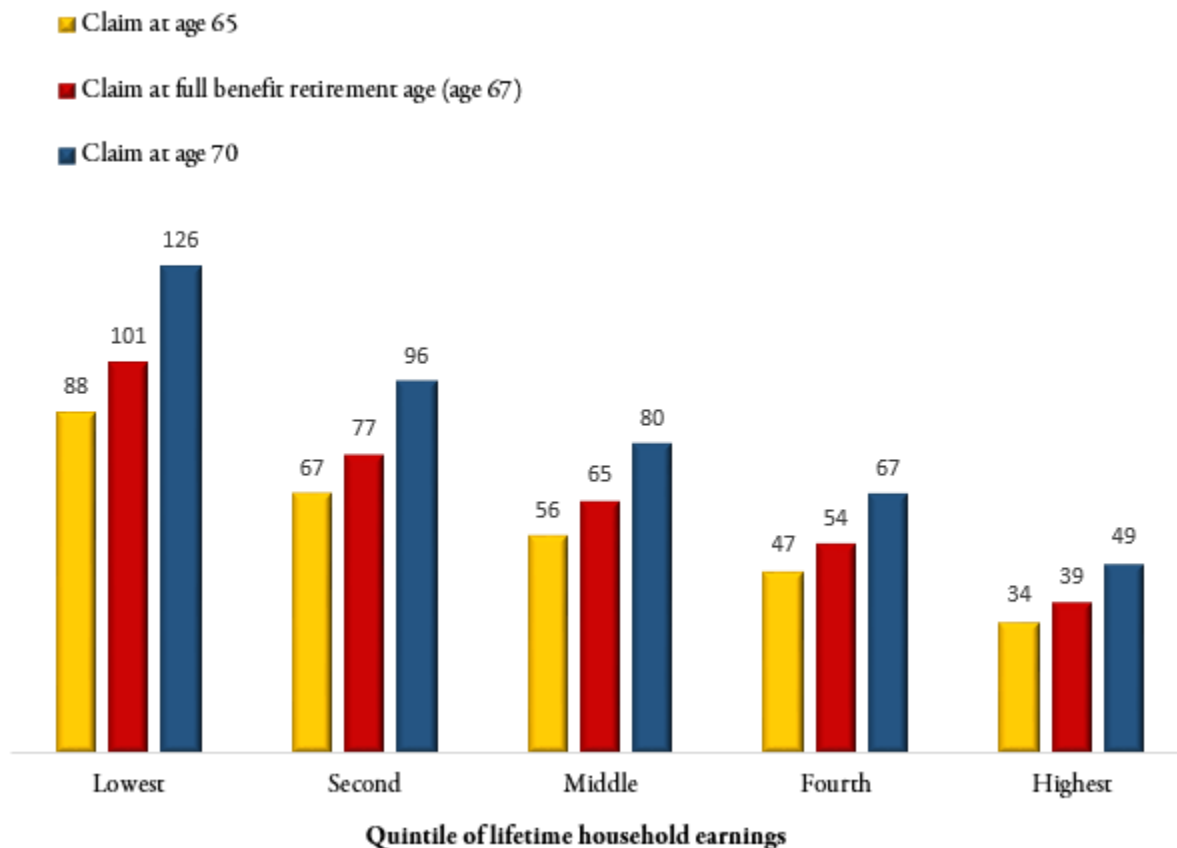
<sup>59</sup> Benefits would continue to increase with delayed claiming up to age 70. If claiming was delayed until age 70, benefits would increase an additional 24 percent compared with claiming at age 67. If workers claimed at age 70, the replacement

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**Figure 9**

**Workers Can Increase Social Security Benefits by Delaying Claiming**

*Average Social Security replacement rates by quintile of lifetime household earnings and claiming age, 1960s birth cohort, percent*



Note: For each worker, the replacement rate is the ratio of Social Security benefits to average inflation-indexed lifetime earnings.

Sources: Congressional Budget Office, *The 2014 Long-Term Projections for Social Security: Additional Information*, and Investment Company Institute

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From its more modest beginnings, the current Social Security system is designed to provide a full pension to workers with low lifetime earnings, and to provide a substantial share of retirement resources for workers with moderate or high lifetime earnings. Consistent with the design of the system, Social Security benefits comprise a higher share of retirement resources for retirees with low wealth or low income. In contrast, to maintain their standard of living in retirement, higher-earning households have a greater need to supplement Social Security benefits.

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rate for workers in the lowest-earning 20 percent of households would increase to 126 percent and the replacement rate would increase to 80 percent for workers in the middle 20 percent of households (*see* Figure 9).

## **2. Homeownership**

A second resource available to the vast majority of retired households is the home in which they live.<sup>60</sup> Homeownership increases with age and is high across all income groups among near-retiree households. Households who own homes often have no or low mortgage debt by the time they reach retirement age. Households do not have to sell their homes to benefit from them in retirement; they simply have to live in them. An owner-occupied home functions like an annuity that provides rent, as the home provides a place to live that otherwise would have to be rented.

## **3. Employer-Sponsored Retirement Plans and IRAs**

The next two layers of the retirement resource pyramid consist of accumulations in employer-sponsored retirement plans (both private-sector employer and government employer plans, including both DB and DC plans) and IRAs (both contributory and those resulting from rollovers from employer-sponsored plans). Near-retiree households across all income groups have these retirement benefits, but employer-sponsored retirement plans and IRAs typically provide a larger share of resources for higher-income households, for whom Social Security benefits provide a smaller share.

The share of households with retirement accumulations—that is, with benefits accrued in a DB plan or assets in a DC plan or IRA—follows a life-cycle pattern. Based on data from the 2013 Survey of Consumer Finances (SCF), conducted by the U.S. Federal Reserve Board, the share of households with retirement accumulations increases from 22 percent of households younger than 25, to 61 percent of households aged 35 to 44, to 73 percent of households aged 65 to 74 (*see* Figure 10). Similarly, among those with a DC plan or IRA, median retirement assets increase from \$2,300 for households younger than 25, to \$42,700 for households aged 35 to 44, to \$149,000 for households aged 65 to 74.

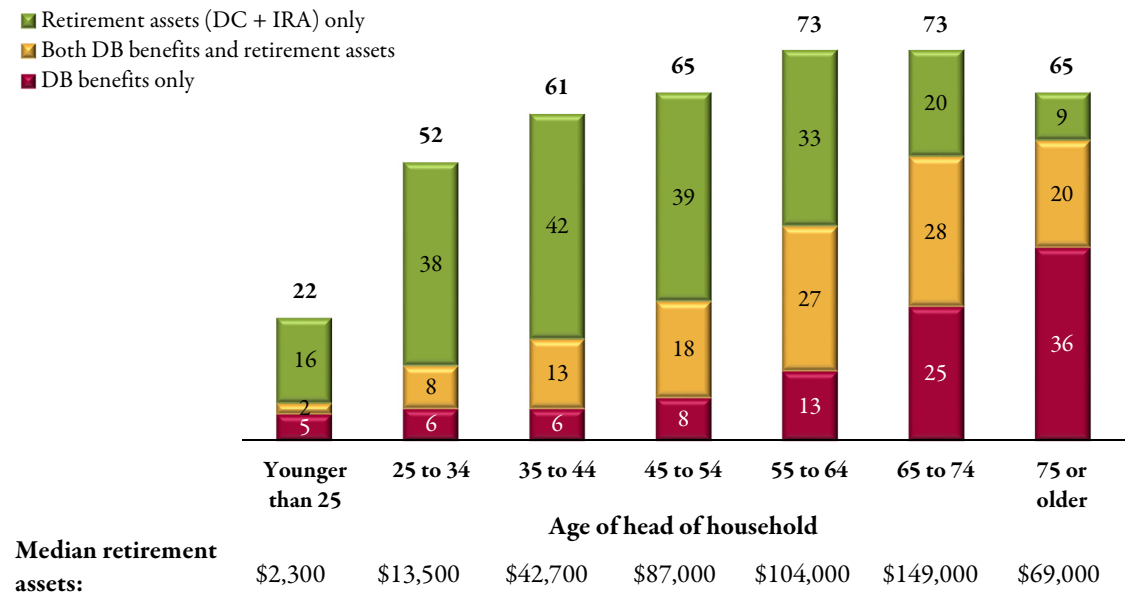
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<sup>60</sup> See Brady, Burham, and Holden, *The Success of the U.S. Retirement System*, Investment Company Institute (December 2012), at pp. 22–26.

**Figure 10**

**Share of Households with DB, DC, or IRA Increases with Age, as Do Retirement Assets**

*Percentage of households by age of household head, 2013*



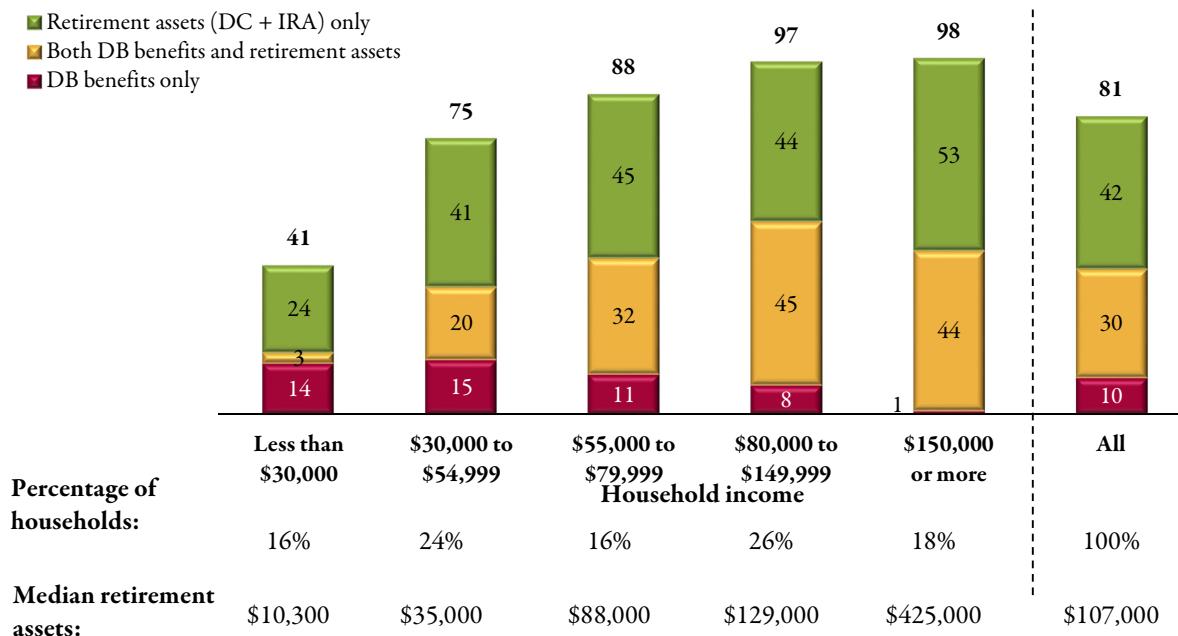
Note: Retirement assets include DC plan assets and IRAs. DB benefits include households currently receiving DB benefits and households with the promise of future DB benefits. Components may not add to the total because of rounding.

Source: Investment Company Institute tabulation of the 2013 Survey of Consumer Finances

Figure 10 analyzes the incidence of retirement accumulations by age of household across all households to highlight the life-cycle pattern of focus on saving for retirement. Figure 11 looks more closely at households who are still working and are getting close to retirement. Among these near-retiree households—that is, working households aged 55 to 64—81 percent have retirement accumulations and, among those with DC plans or IRAs, median retirement assets are \$107,000 (*see* Figure 11). Near-retiree households across all income groups have retirement accumulations, including 41 percent of near-retiree households with income less than \$30,000 and 75 percent of near-retiree households with income of \$30,000 to \$54,999. For the top 60 percent of households by income, over 90 percent have retirement accumulations.

**Figure 11**  
**Near-Retiree Households Across All Income Groups Have Retirement Assets, DB Plan Benefits, or Both**

*Percentage of households with working head aged 55 to 64, by household income, 2013*



Note: Near-retiree households are households with a working head aged 55 to 64 in 2013, excluding the top and bottom 1 percent of the income distribution. Retirement assets include DC plan assets and IRAs. DB benefits include households currently receiving DB benefits and households with the promise of future DB benefits. Components may not add to the total because of rounding.

Source: Investment Company Institute tabulation of the 2013 Survey of Consumer Finances

As with Social Security benefits, assets specifically earmarked for retirement have increased significantly over time. In 1975, aggregate retirement assets, including assets in DB plans, represented about \$27,900 per household in constant 2014 dollars. By year-end 2014, that figure stood at about \$199,200—7.1 times the level in 1975.<sup>61</sup>

<sup>61</sup> See Brady, Burham, and Holden, *The Success of the U.S. Retirement System*, Investment Company Institute (December 2012), Figure 4, p. 11 (updated to year-end 2014).



## V. THE VOLUNTARY EMPLOYER-SPONSORED RETIREMENT SYSTEM IS CHARACTERIZED BY FLEXIBILITY, COMPETITION, AND INNOVATION

### A. Flexibility Has Led to Innovation

A strength of the voluntary employer-provided retirement system is the flexibility built into its design. This flexibility has allowed a tremendous amount of innovation to take place over the past few decades, due to the combined efforts of employers, employees, and plan service providers. Some of these innovations—for example, making contributions through regular payroll deduction, which provides convenience and stability, or employer matching contributions, designed to provide further incentives for employee participation—are now taken for granted as standard plan features. Another important improvement has been automatic enrollment to increase plan participation.<sup>62</sup> Another change, auto-escalation, gradually increases the share of pay contributed each pay period until an employee's savings rate reaches a desired goal. Further, target date funds also have become increasingly popular both as a default and as an employee choice and have been successful in ensuring that investors have a diversified portfolio that rebalances to be more focused on income and less focused on growth over time.<sup>63</sup>

It is important to remember that the employer-sponsored retirement system is premised on its voluntary and flexible nature. Employers can choose to provide retirement plans to their employees tailored to their specific needs—but they are not required to do so. Employers today can select from a wide range of retirement plan options including payroll-deduction IRAs, SEP IRAs, SIMPLE IRAs, safe-harbor 401(k) plans, traditional and Roth 401(k) plans, and in some cases, 403(b) plans.<sup>64</sup> A payroll-deduction IRA program has virtually no set-up costs beyond establishing a payroll feed. Retirement savings opportunities—for those who value them—are not lacking.

The current tax structure—including allowing the deferral of tax on compensation contributed to employer-sponsored retirement plans—provides a strong and effective incentive for individuals at all income levels to save for retirement and encourages employers to sponsor plans that provide significant

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<sup>62</sup> The EBRI/ICI 401(k) Accumulation Projection Model demonstrates the increases in retirement income that can result from automatic enrollment. Replacement rates, modeled after adding automatic enrollment and investing contributions in a target date fund, increase significantly. See Holden and VanDerhei, “The Influence of Automatic-Enrollment, Catch-Up, and IRA Contributions on 401(k) Accumulations at Retirement,” *Investment Company Institute Perspective* 11, no. 2, and *EBRI Issue Brief*, no. 283 (July 2005), available at [www.ici.org/pdf/per11-02.pdf](http://www.ici.org/pdf/per11-02.pdf) and [www.ebri.org/pdf/briefspdf/EBRI\\_IB\\_07-20054.pdf](http://www.ebri.org/pdf/briefspdf/EBRI_IB_07-20054.pdf). Furthermore, studies find that adopting an automatic enrollment feature has a particularly strong impact on improving participation rates among low-income and younger workers. See, e.g., Utkus and Young, *How America Saves, 2015: A report on Vanguard 2014 defined contribution plan data*, Vanguard Center for Retirement Research (2015), available at <https://institutional.vanguard.com/iam/pdf/HAS15.pdf>.

<sup>63</sup> See Charlson, “Diversification Pays Off for Target-Date Funds,” *Morningstar Advisor* (January 17, 2013), available at [www.morningstar.com/advisor/t/69996173/diversification-pays-off-for-target-date-funds.htm](http://www.morningstar.com/advisor/t/69996173/diversification-pays-off-for-target-date-funds.htm).

<sup>64</sup> See, e.g., “Choosing a Retirement Solution for Your Small Business,” Internal Revenue Service and Department of Labor, available at [www.irs.gov/pub/irs-pdf/p3998.pdf](http://www.irs.gov/pub/irs-pdf/p3998.pdf).

benefits to American workers of all income levels. Of course, any changes in the retirement tax incentives could dramatically affect a prior decision to sponsor a plan and require employers to reevaluate and potentially redesign their retirement plan offerings, or even to decide to eliminate their plans entirely.

## **B. 401(k) Plan Costs Have Fallen over Time**

Employers design and offer 401(k) plans to compete for and attract and retain qualified workers, and financial services companies compete to provide services to the plans. Competition and a growing asset base have contributed to the success of 401(k) plans by reducing costs, resulting in cost-effective investing for 401(k) participants. Whether measured by the average total expense ratios of mutual funds held in 401(k) plans, by “all-in” 401(k) plan fees (including all fees whether paid by the plan sponsor, the plan, or the participant), or by “total plan cost” (reflecting fees paid by the plan or the participants), the cost of 401(k) plans has fallen over time.

Analyzing plan sponsor data, it is possible to gain insight into how total 401(k) plan expenses and fees have changed over time. For example, Deloitte Consulting/Investment Company Institute surveys of plan sponsors find that the median all-in fee in 401(k) plans declined between 2011 and 2013.<sup>65</sup> BrightScope’s total plan cost measure, based on Form 5500 annual filings and industry data, indicates that 401(k) plan fees fell between 2009 and 2012.<sup>66</sup>

Institute research shows that the costs 401(k) plan participants have incurred for investing in long-term mutual funds have trended down over the past nearly decade and a half. For example, in 2000, 401(k) plan participants incurred expenses of 0.77 percent of the 401(k) assets they held in equity funds (see Figure 12).<sup>67</sup> By 2014, that had fallen to 0.54 percent, a 30 percent decline.<sup>68</sup> The expenses 401(k) plan participants incurred for investing in hybrid and bond funds also fell from 2000

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<sup>65</sup> See Deloitte Consulting LLP and Investment Company Institute, *Inside the Structure of Defined Contribution/401(k) Plan Fees, 2013: A Study Assessing the Mechanics of the “All-In” Fee*, New York: Deloitte Consulting LLP and Washington, DC: Investment Company Institute (August 2014), available at [www.ici.org/pdf/rpt\\_14\\_dc\\_401k\\_fee\\_study.pdf](http://www.ici.org/pdf/rpt_14_dc_401k_fee_study.pdf).

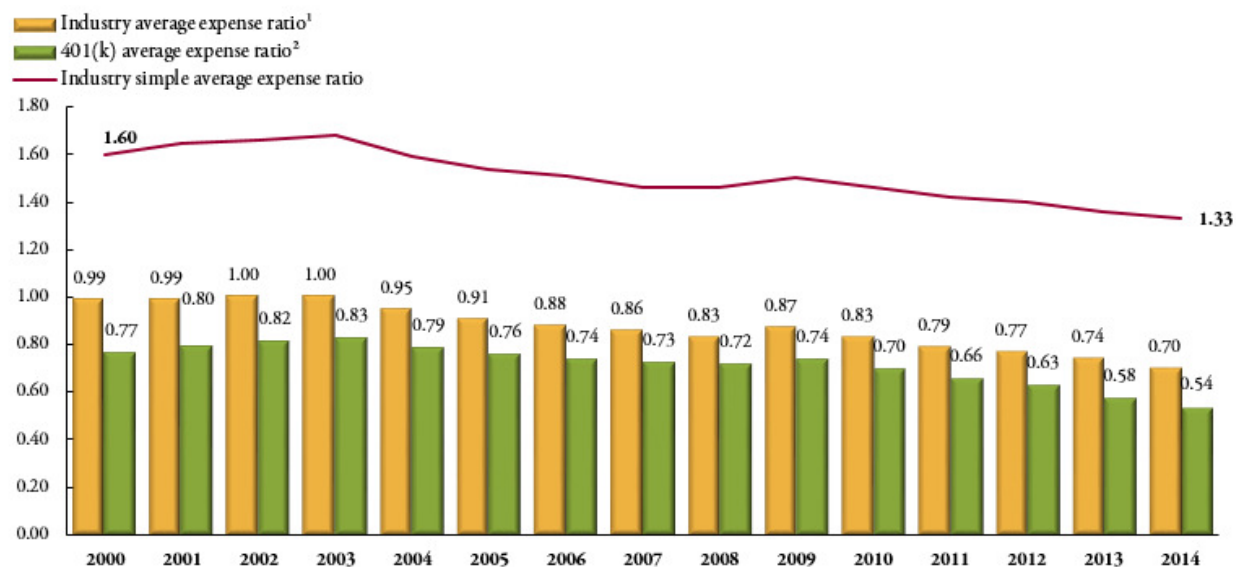
<sup>66</sup> See BrightScope and Investment Company Institute, *The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans*, San Diego, CA: BrightScope and Washington, DC: Investment Company Institute (December 2014), available at [www.ici.org/pdf/ppr\\_14\\_dcplan\\_profile\\_401k.pdf](http://www.ici.org/pdf/ppr_14_dcplan_profile_401k.pdf). In addition, analysis of ERISA 403(b) plans (another type of DC plan) finds that their total plan costs have fallen as well. See BrightScope and Investment Company Institute, *The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at ERISA 403(b) Plans*, San Diego, CA: BrightScope and Washington, DC: Investment Company Institute (June 2015), available at [www.ici.org/pdf/ppr\\_15\\_dcplan\\_profile\\_403b.pdf](http://www.ici.org/pdf/ppr_15_dcplan_profile_403b.pdf).

<sup>67</sup> See Collins, Holden, Chism, and Duvall, “The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2014,” *ICI Research Perspective* 21, no. 3 (August 2015), available at [www.ici.org/pdf/per21-03.pdf](http://www.ici.org/pdf/per21-03.pdf).

<sup>68</sup> *Id.* (Figure 6, p. 11).

to 2014, by 24 percent and 28 percent, respectively.<sup>69</sup> It is also significant that participants in 401(k) plans tend to pay lower fees than fund investors overall. The 0.54 percent paid by 401(k) investors in equity funds is lower than the expenses paid by all equity fund investors (0.70 percent) and less than half the simple average expense ratio on equity funds offered for sale in the United States (1.33 percent). The experience of hybrid and bond fund investors is similar.

**Figure 12**  
**401(k) Mutual Fund Investors Concentrate Their Assets in Lower-Cost Equity Funds**  
*Percent, 2000–2014*



<sup>1</sup>The industry average expense ratio is measured as an asset-weighted average.

<sup>2</sup>The 401(k) average expense ratio is measured as a 401(k) asset-weighted average.

Note: Data exclude mutual funds available as investment choices in variable annuities.

Sources: Investment Company Institute and Lipper; see Collins, Holden, Chism, and Duvall, “The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2014,” *ICI Research Perspective* 21, no. 3 (August 2015)

## VI. EFFECTIVE POLICYMAKING REQUIRES A BETTER UNDERSTANDING OF THE “COVERAGE GAP”

While the current laws and policies governing retirement saving are working well and are helping tens of millions of American workers accumulate savings and generate retirement income, some argue that the system is a failure because some Americans do not have access to an employer-sponsored retirement plan. This perceived failure is referred to as the “coverage gap.” This “gap” is poorly understood and frequently incorrectly measured.

<sup>69</sup> *Ibid.*

The fact is that the vast majority of private-sector workers needing and demanding access to pensions as part of their compensation have pension plan coverage.<sup>70</sup> Accordingly, any assessment of proposals intended to increase coverage must be based on a factual understanding of the reasons some employers do not offer retirement plans to their workers.

#### **A. Workforce Composition Plays a Key Role in Whether an Employer Offers a Plan**

Differences in workforce composition appear to be a primary cause for the lower rate at which small employers sponsor retirement plans.<sup>71</sup> Employers offer benefits that their employees value and prefer to receive in lieu of higher wages. Employers that have workforces that are more focused on saving for retirement—and, thus, more likely to value retirement benefits—are more likely to offer retirement plans. This is consistent with the empirical evidence, which shows that firms sponsoring retirement plans have workforces that are older, have higher earnings, and are more likely to work full-time for a full year.

This is because older households are more likely to save primarily for retirement, and thus are more likely to prefer having a portion of their compensation in the form of retirement benefits. Younger households, on the other hand, are more likely to report that they save primarily for reasons other than retirement—for example, to pay for education, to buy a house, or for the family.<sup>72</sup>

Among employers that do not sponsor retirement plans, 29 percent of their employees are younger than 30; 57 percent of their employees are low earners; and 39 percent of their employees are not full-time, full-year (*see* Figure 13). In contrast, among employers that do sponsor retirement plans, only 20 percent of their employees are young; only 25 percent are low earners; and only 20 percent are not full-time, full-year.

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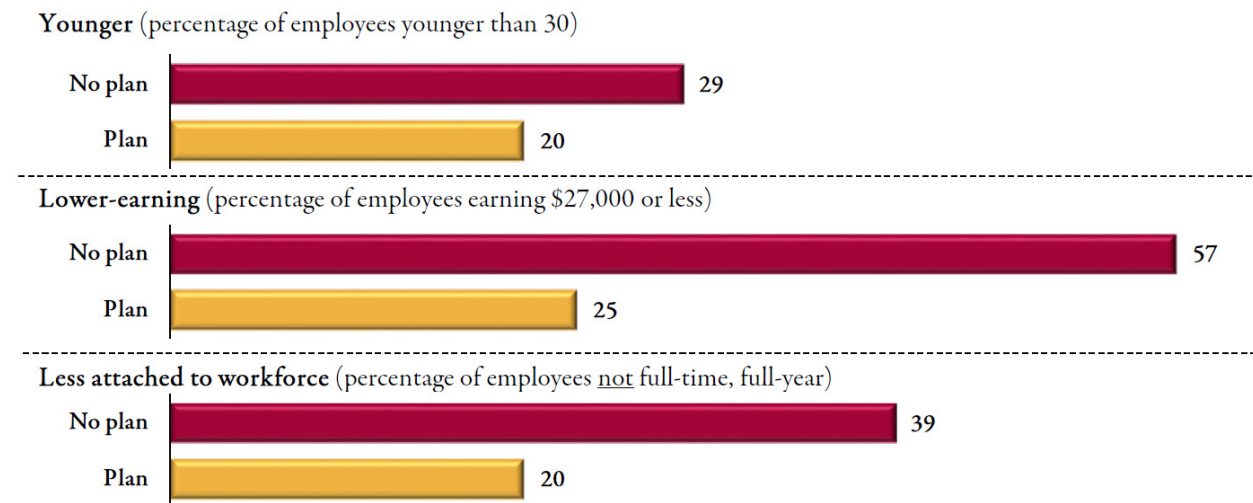
<sup>70</sup> See Brady and Bogdan, “Who Gets Retirement Plans and Why, 2013,” *ICI Research Perspective* 20, no. 6 (October 2014), available at [www.ici.org/pdf/per20-06.pdf](http://www.ici.org/pdf/per20-06.pdf). Current Population Survey (CPS) data for 2013 indicate that 53 percent of private-sector wage and salary workers aged 21 to 64 were employed by firms that sponsored retirement plans (including both DB and DC plans). However, access to retirement plans is not random. Limiting the analysis to full-time, full-year workers aged 30 to 64, access to retirement plans increases to 62 percent. If the analysis is narrowed further to the groups of workers most likely to be focused on saving for retirement—workers aged 30 or older with at least moderate levels of earnings and all but the lowest earning workers aged 45 or older—then 70 percent work for employers that sponsor retirement plans. In addition, some in this group without access to plans at their own employers have access to plans through their spouses’ employers. Taking into account access through spouses, 75 percent of workers who are likely to be focused on saving for retirement have access to employer-provided retirement plans, and 93 percent participate in the plans offered.

<sup>71</sup> See Brady and Bogdan, “Who Gets Retirement Plans and Why, 2013,” *ICI Research Perspective* 20, no. 6 (October 2014).

<sup>72</sup> *Id.* (Figure 1, p. 5, which has ICI tabulations of the 2013 SCF analyzing households’ primary reasons for saving and how they vary with age and income).

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**Figure 13**  
**Companies That Don't Offer Pension Plans Have Workforces That Are:**



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Note: This analysis is of private-sector workers aged 21 to 64.

Source: Investment Company Institute tabulation of March 2014 Current Population Survey; see Brady and Bogdan, "Who Gets Retirement Plans and Why, 2013," *ICI Research Perspective* 20, no. 6 (October 2014)

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Workers who work part-time or part-year are less likely to be focused on saving for retirement because, on average, they have low earnings. If they typically work part-time or part-year, Social Security benefits will replace a high share of their earnings (see Figure 9, above). If they typically work full-time or full-year, they likely would delay saving until they return to more normal work.

Small employers are much less likely to offer a retirement plan than large employers.<sup>73</sup> As a group, small firms are more likely than large firms to have a large share of their employees who are lower-earning and who work part-time or part-year. For many small employers, their employees are likely to value retirement benefits less than higher wages or employer-sponsored health insurance and other benefits (see Figure 14).

Current plan structures discourage employers from offering plans if many or most of their workers are less likely to value a retirement plan. If many or most of a firm's workers do not value a retirement plan, and thus do not participate, the firm's plan is not likely to meet tax code nondiscrimination tests. Employers can create safe harbor plans through auto enrollment and mandatory employer contributions, but those measures raise the employer's cost of offering plans.

If such firms could offer a retirement plan that did not have to meet nondiscrimination tests and did not require employer contributions, our research suggests that some employers that currently do not offer such plans might do so.

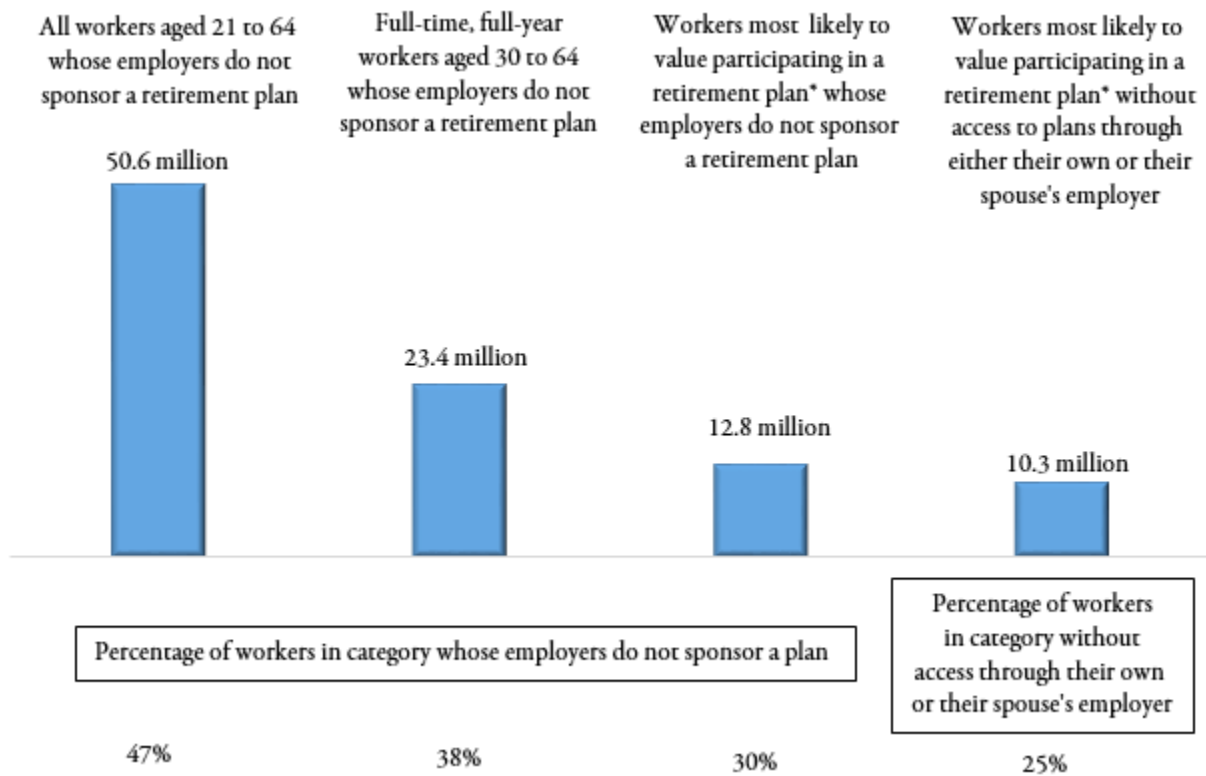
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<sup>73</sup>See Brady and Bogdan, "Who Gets Retirement Plans and Why, 2013," *ICI Research Perspective* 20, no. 6 (October 2014).

**Figure 14**

**Only a Minority of Workers Without Access to an Employer-Sponsored Retirement Plan Are Likely to Value a Plan**

*Workers without access to a retirement plan by selected categories of workers*



\*Full-time, full-year workers aged 30 to 44 with annual earnings of \$45,000 or more; and full-time, full-year workers aged 45 to 64 with annual earnings of \$25,000 or more.

Source: Investment Company Institute tabulations of March 2014 Current Population Survey; see Brady and Bogdan, "Who Gets Retirement Plans and Why, 2013," *ICI Research Perspective* 20, no. 6 (October 2014)

**B. Most Workers Have Access to Savings Plans Through IRAs or Plans for the Self-Employed**

It is important to remember that individuals who are not offered an employer-sponsored plan do have options for saving. All households with earned income have access to IRAs to save for retirement on a tax-advantaged basis. Congress designed the traditional IRA with two goals in mind: (1) to create a contributory retirement account for workers, and (2) to provide a rollover vehicle to preserve assets accumulated in employer-sponsored retirement plans (both DB and DC). IRAs typically have very small minimum opening balance requirements. Although a small share of individuals

contributes to traditional IRAs in any given year,<sup>74</sup> the majority of those who contribute make repeat contributions in succeeding years.<sup>75</sup> In addition, many of those IRA investors contributing to traditional IRAs contribute at the limit.<sup>76</sup>

Self-employed individuals also have ready access to various convenient retirement plan options. Simplified Employee Pensions (“SEP IRAs”), SIMPLE IRAs, and solo-401(k) plans are all easy to establish and maintain. Moreover, self-employed individuals often find it advantageous to set up a DB plan.

### **C. Most Workers Will Accumulate Retirement Benefits During Their Careers**

Many more workers will have access to an employer-sponsored retirement plan at some point during their working careers and will reach retirement with work-related retirement benefits than is implied by looking at a snapshot of coverage among all workers at any point in time. Data from the SCF show that about 80 percent of near-retiree households in 2013 had accrued benefits and asset accumulations in employer-sponsored retirement plans and IRAs (*see* Figure 15).<sup>77</sup> For the past two decades about 80 percent of near-retiree households—those with a working head of household aged 55 to 64 in the year indicated—have consistently accrued DB, DC, or both types of retirement plan benefit (from private-sector employer and government employer plans), or IRAs (rollover and contributory). Despite the fact that DC plans have grown relative to DB plans among private-sector employers, the portion of near-retiree households with retirement accumulations has remained stable. What has changed is the composition of those retirement accumulations: in 1989, 55 percent of near-retiree households had DB benefits and 60 percent had retirement assets (DC plans or IRAs, or both), compared with 2013, when 40 percent of near-retiree households had DB benefits and 72 percent had retirement assets.

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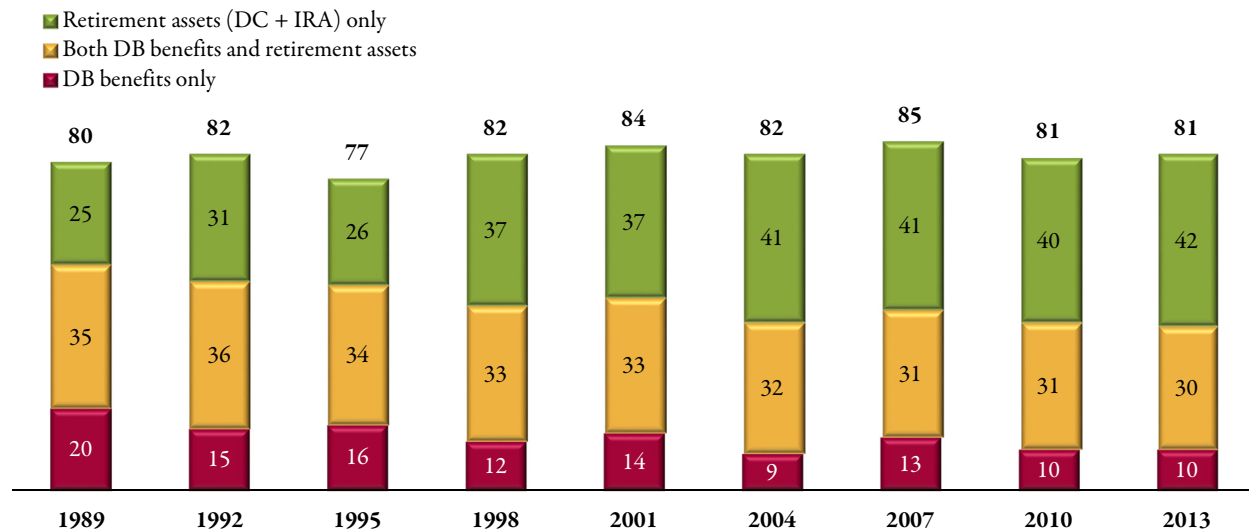
<sup>74</sup> A number of factors may account for this relatively low contribution rate. Two of the major determinants of individuals’ decisions to contribute to traditional IRAs are their assessment of their need for additional retirement savings and their ability to deduct contributions from their taxable income. Individuals who are covered by retirement plans at work may find that they can meet their saving needs through those plans. In addition, coverage by such plans may curtail their eligibility to make tax-deductible contributions. For lower-income households, Social Security replaces a much higher fraction of pre-retirement earnings, which may reduce their need for additional retirement savings. Furthermore, there is some evidence that confusion about IRA rules may prevent some individuals from contributing. *See* Holden and Bass, “The IRA Investor Profile: Traditional IRA Investors’ Activity, 2007–2013,” *ICI Research Report* (July 2015), available at [www.ici.org/pdf/rpt\\_15\\_ira\\_traditional.pdf](http://www.ici.org/pdf/rpt_15_ira_traditional.pdf).

<sup>75</sup> *Id.* (Figure 2.7, p. 32).

<sup>76</sup> *Id.* (Figures 2.5 and 2.6, pp. 30–31).

<sup>77</sup> Update of tabulations in Brady, Burham, and Holden, *The Success of the U.S. Retirement System*, Figure 13, p. 29.

**Figure 15**  
**Vast Majority of Near-Retiree Households Have Accrued Pension Benefits**  
*Percentage of near-retiree households, 1989–2013*



Note: Near-retiree households are households with a working head aged 55 to 64 in the year indicated, excluding the top and bottom 1 percent of the income distribution. Retirement assets include DC plan assets and IRAs. DB benefits include households currently receiving DB benefits and households with the promise of future DB benefits. Components may not add to the total because of rounding.

Source: Investment Company Institute tabulation of the 1989–2013 Survey of Consumer Finances

## VII. STATE-ADMINISTERED RETIREMENT PLAN PROPOSALS RAISE SUBSTANTIAL QUESTIONS AND MERIT CLOSE SCRUTINY

Over the past few years, several states have taken steps to establish state-administered retirement plans for resident private-sector workers. These initiatives generally are in response to concerns that private-sector employees in these states do not have sufficient access to retirement savings opportunities through their employers. For example, California, Illinois, and Oregon have enacted legislation to implement mandatory state-administered retirement plans for private-sector employees. Massachusetts has passed legislation to offer a voluntary DC program for employees of small non-profits in that state and, more recently, Washington enacted legislation creating a voluntary retirement “marketplace” to connect small employers with financial institutions offering retirement plan options. Several other states are considering whether to create similar plans or to conduct feasibility studies.

These state initiatives raise significant questions, and we urge that Congress consider them carefully.

- **Are the state-run plan proposals based on an accurate understanding of coverage statistics and the role that workforce composition plays in plan sponsorship?** As explained earlier, the vast majority of private-sector workers needing and demanding access to pensions as part of



their compensation have pension plan coverage.<sup>78</sup> Moreover, firms that do not sponsor plans are more likely to have workforces that place less value on retirement benefits than other forms of compensation. These workers may be saving primarily for reasons other than retirement—such as education, buying a house, or starting a family—or may have day-to-day needs that preclude current saving. It bears repeating that Social Security provides very high replacement rates for individuals in lower-earning households.<sup>79</sup> All of these factors bear on the fundamental rationale for the state-run plan initiatives.

- **Are the costs and burdens that will be imposed on employers subject to state mandates to offer such plans, and the possible costs to state taxpayers, justified by the likelihood of benefits that workers will value?** The research discussed above suggests that many of the workers whose employers would be subject to state mandates (because they do not offer a retirement plan) likely would opt out of participating. If state programs do not have the desired effect of increasing participation among certain worker populations, they may not justify the costs and burdens they will impose, especially on small employers.
- **What are the implications of an escalating number of different state-administered plans for private-sector workers—for multi-state employers, for workers who move from one state to another, and for the marketplace for retirement plan products and services?** A proliferation of state-run retirement programs for private-sector workers could result in conflicting requirements for employers with workers in more than one state. Such a patchwork of solutions also could be confusing to individual retirement savers and may leave workers who move from a state with such a plan no ability either to continue participating in the plan or to transfer the assets accrued to another plan.
- **Will state-run plan options erode the successes of the current voluntary employer-sponsored system, by prompting employers currently offering plans to drop their 401(k) plans in favor of the state option?** Implementation of some proposed state plans is premised on exemption from federal laws like ERISA, and the Department of Labor has been directed to issue guidance by the end of this year to support the states' efforts.<sup>80</sup> If state-run plans are exempted from ERISA, such plans could become a more attractive option for employers in terms of reduced compliance burdens, costs and legal liabilities. Policymakers need to determine whether such programs have the potential to prompt a “race to the bottom,” leading to an erosion of the existing 401(k) system.

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<sup>78</sup> See note 70 and accompanying text at p. 43, *supra*.

<sup>79</sup> See discussion of Social Security replacement rates and how the role of Social Security varies by income and wealth on pp. 33–36, *supra*.

<sup>80</sup> See U.S. Department of Labor, *Fact Sheet* (July 13, 2015), available at [www.dol.gov/ebsa/pdf/fswhconferenceonaging.pdf](http://www.dol.gov/ebsa/pdf/fswhconferenceonaging.pdf).

- **What type of investor protections will apply to participants in state-run plans, particularly if state-run plans are exempted from ERISA or federal securities laws?** Policymakers must consider whether government exemptions from investor protections like ERISA for state-sponsored retirement plans could create significant advantages for such plans at the expense of plan participants and private-sector plan sponsors. Many open questions remain about the state programs, such as whether the protections of the Investment Company Act of 1940 will apply to the plans' underlying investments; whether assets will be held in trust; what reporting, valuation, and other requirements will apply; and what disclosures participants will receive.
- **How will the administrative costs of such state-run plans be covered?** Consideration must also be given to how the plans will be administered. Will plan recordkeeping be performed by the states, necessitating significant investment in systems and personnel? Who will pay such costs—taxpayers, or the private-sector employees and employers participating in the programs?
- **What governance structure applies to such state-run plans?** Many of the states enacting such programs contemplate that the plans will be administered by state-appointed boards, raising questions regarding potential conflicts of interest, political favoritism, and similar concerns that need to be addressed. In addition, proposals like the California Secure Choice Retirement Savings Program, which would allocate a guaranteed rate of return to participant accounts, raise substantial questions about the potential for conflicts of interest arising when managers of large pools of money have competing obligations to both private- and public-sector employees.

The above list of questions is not exhaustive. Rather, the questions simply illustrate the complex issues that state-run plan proposals for private-sector employees raise. These issues deserve Congress's consideration. Perhaps the biggest question of all is this: **What changes at the federal level might help expand retirement plan coverage and obviate the need for a patchwork of state-administered plans?**

In this regard, we would urge that Congress consider targeted changes to the current national system. Two ideas in particular would help bring more employers into and improve the effectiveness of the voluntary private-sector retirement system, without detracting from the system's successful features. These ideas would be simple to implement.

New SIMPLE Plan. While the existing SIMPLE IRA and other available plan options<sup>81</sup> offer a relatively simple solution to plan sponsorship, none of the existing plan options work well for workplaces where the majority of workers are focused on saving for goals other than retirement—such as education, a home, or an emergency fund. Many small employers want to offer employees the option to contribute to a 401(k) or similar plan, but cannot meet the non-discrimination tests and may not have the capacity to make the required employer contributions associated with the safe harbor 401(k) plan or a SIMPLE plan. For employers whose workforce places less value on compensation paid as

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<sup>81</sup> See note 64 and accompanying text, *supra*.

retirement benefits as opposed to take-home wages, the required employer contributions discourage the adoption of SIMPLE plans. Creating a new type of SIMPLE plan for such small employers would encourage greater plan creation and coverage in smaller workplaces. The new plan would be modeled on existing SIMPLE plans, but would not require employer contributions. It would have contribution limits above traditional and Roth IRA limits, but below existing SIMPLE plan limits.<sup>82</sup> Such a plan would accommodate any employee who wants to save for retirement, while preserving the incentives for the employer to step up to a SIMPLE IRA or 401(k) plan.

Open MEPs for Small Employers. The Institute also supports easing restrictions on “open” multiple employer plans (or “open MEPs”) established as DC plans, but targeting the provision to employers with no more than 100 employees—the employer segment most in need of solutions to encourage retirement plan sponsorship.<sup>83</sup> Allowing small employers to participate in a MEP—regardless of the employer’s industry or any other preexisting relationship with other participating employers or the plan sponsor—will reduce administrative and compliance costs and burdens, and ultimately improve the availability of retirement plans to employees of small employers. In addition to administrative and compliance burdens, smaller employers may be challenged by the fiduciary responsibility and liability of selecting and monitoring service providers and plan investment options. By providing a level of liability relief for investment options offered under the plan, small employers would be encouraged to participate in a MEP, while at the same time ensuring that plan participants are protected. Our proposal also includes important safeguards for open MEP arrangements to ensure the legitimacy of the sponsoring entity and that fiduciary standards are met.

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On behalf of the Institute and all of our members, I thank you for the opportunity to offer this statement. I look forward to answering any questions of the Subcommittee.

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<sup>82</sup> We note that a conceptually similar provision, referred to as the “starter k” plan, has been proposed by Senator Orrin Hatch (R-UT) in S. 1270, the “Secure Annuities for Employee (SAFE) Retirement Act of 2013.”

<sup>83</sup> For a discussion of how pension coverage varies by plan size, see Brady and Bogdan, “Who Gets Retirement Plans and Why, 2013,” *ICI Research Perspective* 20, no. 6 (October 2014), available at [www.ici.org/pdf/per20-06.pdf](http://www.ici.org/pdf/per20-06.pdf).