EMPLOYEE BENEFITS SECURITY ADMINISTRATION
UNITED STATES DEPARTMENT OF LABOR

FACTSHEET

www.dol.gov/protectyoursavings/FactSheetCOI

Department of Labor Proposes Rule to Address Conflicts of Interest in Retirement Advice, Saving Middle-Class Families Billions of Dollars Every Year

"Today, I'm calling on the Department of Labor to update the rules and requirements that retirement advisors put the best interests of their clients above their own financial interests. It's a very simple principle: You want to give financial advice, you've got to put your client's interests first."

– President Barack Obama, February 23, 2015

Middle class economics means that Americans should be able to retire with dignity after a lifetime of hard work. But loopholes in the retirement advice rules have allowed some brokers and other advisers to recommend products that put their own profits ahead of their clients' best interest, hurting millions of America's workers and their families.

A system where firms can benefit from backdoor payments and hidden fees often buried in fine print if they talk responsible Americans into buying bad retirement investments—with high costs and low returns—instead of recommending quality investments isn't fair. A White House Council of Economic Advisers analysis found that these conflicts of interest result in annual losses of about 1 percentage point for affected investors—or about $17 billion per year in total. To demonstrate how small differences can add up: A 1 percentage point lower return could reduce your savings by more than a quarter over 35 years. In other words, instead of a $10,000 retirement investment growing to more than $38,000 over that period after adjusting for inflation, it would be just over $27,500.

In February, the President directed the Department of Labor to move forward with a proposed rulemaking to require retirement advisers to abide by a "fiduciary" standard—putting their clients' best interest before their own profits. And today, the Department of Labor is taking the next step toward making that a reality, by issuing a Notice of Proposed Rulemaking (NPRM) to require that best interest standard across a broader range of retirement advice to protect more investors.

Today's proposal is the result of years of work and reflects feedback from a broad range of stakeholders—including industry, consumer advocates, Congress, retirement groups, academia, and the American public. The proposal includes broad, flexible exemptions from certain obligations associated with a fiduciary standard that will help streamline compliance while still requiring advisers to serve the best interest of their clients.

In the coming months, the Administration welcomes comments on the proposal and looks forward to working with all stakeholders to achieve the commonsense goals of the rule while minimizing disruptions to the many good practices in industry. Many advisers already put their customers' best interest first. They are hardworking men and women who got into this work to help families achieve retirement security. They deserve a level playing field, and their clients deserve the quality advice that this rule will ensure.

Updating Our Outdated Retirement Protections

Since 1974, the Employee Retirement Income Security Act (ERISA) has provided the Department of Labor (DOL) with authority to protect America's tax-preferred retirement savings, recognizing the importance of consumer protections for a basic retirement nest egg and the significant tax incentives provided to encourage Americans to save for retirement. But the basic rules governing retirement investment advice have not been meaningfully changed since 1975, despite the dramatic shift in our private retirement system away from defined benefit plans and into self-directed IRAs and 401(k) s. That shift means good investment advice is more important than ever. Today, DOL is proposing a new rule that will seek to:

- **Require more retirement investment advisers to put their client's best interest first, by expanding the types of retirement investment advice covered by fiduciary protections.** Today large loopholes in the definition of retirement investment advice under outdated DOL rules expose many middle-class families, and especially IRA owners, to advice that may not be in their best interest. Under DOL's proposed definition, any individual receiving compensation for providing advice that is individualized or specifically directed to a particular plan sponsor (e.g., an employer with a retirement plan), plan participant, or IRA owner for consideration in making a retirement investment decision is a fiduciary. Such decisions can include, but are not limited to, what assets to purchase or sell and whether to rollover from an employer-based plan to an IRA. The fiduciary can be a broker, registered investment adviser, insurance agent, or other type of adviser (together referred to as "advisers" here). Some of these advisers are subject to federal securities laws and some are not. Being a fiduciary simply means that the adviser must provide impartial advice in their client's best interest and cannot accept any payments creating conflicts of interest unless they qualify for an exemption intended to assure that the customer is adequately protected. DOL's regulatory impact analysis estimates that the rule and related exemptions would save investors over $40 billion over ten years, even if one focuses on just one subset of transactions that have been the most studied. The real savings from this proposal are likely much larger as conflicts and their effects are both pervasive and well hidden.

SUMMARY OF TODAY'S ACTION TO PROTECT RETIREMENT SAVERS BY THE DEPARTMENT OF LABOR

Today, the Department of Labor issued a proposed rulemaking to protect investors from backdoor payments and hidden fees in retirement investment advice.

- **Backdoor Payments & Hidden Fees Often Buried in Fine Print Are Hurting the Middle Class:** Conflicts of interest cost middle-class families who receive conflicted advice huge amounts of their hard-earned savings. Conflicts lead, on average, to about 1 percentage point lower annual returns on retirement savings and $17 billion of losses every year.
- **The Department of Labor is protecting families from conflicted retirement advice.** The Department issued a proposed rule and related exemptions that would require retirement advisers to abide by a "fiduciary" standard—putting their clients' best interest before their own profits.
- **The Proposed Rule Would Save Tens of Billions of Dollars for Middle Class and Working Families:** A detailed Regulatory Impact Analysis (RIA) released along with the proposal and informed by a substantial review of the scholarly literature estimates that families with IRAs would save more than $40 billion over ten years when the rule and exemptions, if adopted as currently proposed, are fully in place, even if one focuses on just one subset of transactions that have been the most studied.
- **The Administration Welcomes Feedback:** The issuance of a notice of proposed rulemaking and proposed exemptions begins a process of seeking extensive public feedback on the best approach to modernize the rules of the road on retirement advice and set new standards, while minimizing any potential disruption to the many good practices in the marketplace. The proposal asks for comments on a number of important issues. We look forward to hearing from all stakeholders. Any final rule and exemptions will reflect this input.

- **Preserve access to retirement education.** The Department's proposal carefully carves out education from the definition of retirement investment advice so that advisers and plan

sponsors can continue to provide general education on retirement saving across employment-based plans and IRAs without triggering fiduciary duties. As an example, education could consist of general information about the mix of assets (e.g., stocks and bonds) an average person should have based on their age, income, and other circumstances, while avoiding suggesting specific stocks, bonds, or funds that should constitute that mix. This carve-out is similar to previously issued guidance to minimize the compliance burden on firms, but clarifies that references to specific investments would constitute advice subject to a fiduciary duty.

- **Distinguish "order-taking" as a non-fiduciary activity.** As under the current rules, when a customer calls a broker and tells the broker exactly what to buy or sell without asking for advice, that transaction does not constitute investment advice. In such circumstances, the broker has no fiduciary responsibility to the client.
- **Carve out sales pitches to plan fiduciaries with financial expertise.** Many large employer-based plans are managed by financial experts who are themselves fiduciaries and work with brokers or other advisers to purchase assets or construct a portfolio of investments that the plan offers to plan participants. In such circumstances, the plan fiduciary is under a duty to look out for the participants' best interest, and understands that if a broker promotes a product, the broker may be trying to sell them something rather than provide advice in their best interest. Accordingly, the proposed rule does not consider such transactions fiduciary investment advice if certain conditions are met.
- **Lead to gains for retirement savers in excess of $40 billion over the next 10 years,** even if one focuses on just one subset of transactions that have been the most studied, according to the regulatory impact analysis released with the NPRM. These gains would be particularly important for the more than 40 million American families with more than $7 trillion in IRA assets, as advice regarding IRA investments is rarely protected under the current ERISA and Internal Revenue Code rules. Moreover, hundreds of billions of dollars are rolled over from plans to IRAs every year. Consumers are especially vulnerable to bad advice regarding rollovers because they represent such a large portion of their savings and because such transactions are also rarely covered under the current rules.

Complying with the Proposed Rule

At present, individuals providing fiduciary investment advice to employer-based plan sponsors and plan participants are required to act impartially and provide advice that is in their clients' best interest. Under ERISA and the Internal Revenue Code, individuals providing fiduciary investment advice to plan sponsors, plan participants, and IRA owners are not permitted to receive payments creating conflicts of interest without a prohibited transaction exemption (PTE). Drawing on comments received and in order to minimize compliance costs, the proposed rule creates a new type of PTE that is broad, principles-based and adaptable to changing business practices. This new approach contrasts with existing PTEs, which tend to be limited to much narrower categories of specific transactions under more prescriptive and less flexible conditions. The "best interest contract exemption" will allow firms to continue to set their own compensation practices so long as they, among other things, commit to putting their client's best interest first and disclose any conflicts that may prevent them from doing so. Common forms of compensation in use today in the financial services industry, such as commissions and revenue sharing, will be permitted under this exemption, whether paid by the client or a third party such as a mutual fund. To qualify for the new "best interest contract exemption," the company and individual adviser providing retirement investment advice must enter into a contract with its clients that:

- **Commits the firm and adviser to providing advice in the client's best interest.** Committing to a best interest standard requires the adviser and the company to act with the care, skill, prudence, and diligence that a prudent person would exercise based on the current circumstances. In addition, both the firm and the adviser must avoid misleading statements about fees and conflicts of interest. These are well-established standards in the law, simplifying compliance.
- **Warrants that the firm has adopted policies and procedures designed to mitigate conflicts of interest.** Specifically, the firm must warrant that it has identified material conflicts of interest and compensation structures that would encourage individual advisers to make recommendations that are not in clients' best interests and has adopted measures to mitigate any harmful impact on savers from those conflicts of interest. Under the exemption, advisers will be able to continue receiving common types of compensation.

- **Clearly and prominently discloses any conflicts of interest, like hidden fees often buried in the fine print or backdoor payments, that might prevent the adviser from providing advice in the client's best interest.** The contract must also direct the customer to a webpage disclosing the compensation arrangements entered into by the adviser and firm and make customers aware of their right to complete information on the fees charged.

In addition to the new best interest contract exemption, the proposal proposes a new, principles-based exemption for principal transactions and maintains or revises many existing administrative exemptions. The principal transactions exemption would allow advisers to recommend certain fixed-income securities and sell them to the investor directly from the adviser's own inventory, as long as the adviser adhered to the exemption's consumer-protective conditions.

Finally, the proposal asks for comment on whether the final exemptions should include a new "low-fee exemption" that would allow firms to accept payments that would otherwise be deemed "conflicted" when recommending the lowest-fee products in a given product class, with even fewer requirements than the best interest contract exemption.

Strengthening Enforcement of Consumer Protections

Existing loopholes mean that many retirement advisers do not consider themselves fiduciaries. As a result, consumers have limited, if any, recourse under ERISA and the Internal Revenue Code if their retirement adviser recommends products that are in the adviser's interest rather than the consumer's. The proposal will not only make more advisers fiduciaries but also ensure they are held accountable to their clients if they provide advice that is not in their clients' best interest, because:

- **DOL currently has the right to bring enforcement actions against fiduciary advisers to plan sponsors and participants who do not provide advice in their clients' best interest.** As under current law, the plan sponsor or plan participant harmed by the bad advice can also bring their own action.
- **The "best interest contract exemption" allows customers to hold fiduciary advisers accountable for providing advice in their best interest** through a private right of action for breach of contract. In other words, if an adviser isn't putting their client's interest first, the client can take action to hold them accountable. This option is especially important for advice regarding IRA investments because otherwise neither DOL nor the saver who is harmed can hold the adviser accountable for the losses the saver suffered. The contract can require that individual disputes be handled through arbitration but must give clients the right to bring class action lawsuits in court if a group of people are harmed. This feature of the best interest contract exemption is modeled on the rules under FINRA, which is a non-governmental organization that regulates advice by brokers to invest in securities but not other types of retirement savings covered by ERISA.
- **The IRS can impose an excise tax on transactions based on conflicted advice** that is not eligible for one of the many proposed exemptions. As under current law, the Internal Revenue Code imposes an excise tax and can require correction of such transactions involving plan sponsors, plan participants and beneficiaries, and IRA owners.

Process Going Forward

The Administration invites stakeholders from all perspectives to submit comments during the 75-day notice and comment period or through the public hearing to be scheduled shortly after the close of the initial public comment hearing. The public record will be reopened for comment after the public hearing is held. Only after reviewing all the comments will the Administration decide what to include in a final rule—and even once the Department of Labor ultimately issues a final rule, it will not go into effect immediately.

How Is This Rule Different from the Proposal in 2010?

In 2010, DOL put forward a proposal to require more retirement investment advice to be in the client's best interest. While many championed the goals of the proposal, some stakeholders expressed concerns during the notice and comment period and at a public hearing. Mindful of these criticisms, and wanting to arrive at the right answer, DOL decided to withdraw the rule and go back to the drawing board. Since 2011, both DOL and the White House have engaged extensively with stakeholders, meeting with industry, advocates, academics—anyone who can help us figure out the best way to craft a rule that adequately protects consumers and levels the playing field for the many advisers doing right by their clients, while minimizing compliance burdens.

The proposal released today has improved upon the 2010 version in a number of ways, both in process and substance:

- **DOL has improved the process to better incorporate stakeholder feedback.**
  - **DOL is issuing proposed exemptions simultaneous with the proposed rule.** Responding to comments received in 2010, DOL is publishing the proposed exemptions alongside the rule so interested parties have a better sense of how the fiduciary requirements and exemptions work together.
  - **DOL has consulted extensively with the Securities and Exchange Commission (SEC) and other federal stakeholders.** Secretary Perez and Chair White have had numerous meetings and conversations, and SEC staff has provided technical assistance and will continue these discussions.
  - **DOL is releasing a more rigorous analysis of the anticipated gains to investors and costs of the rule.** Since 2010, the body of independent research on the costs and consequences of conflicts of interests in retirement investment advice has grown significantly. Today, DOL is releasing a Regulatory Impact Analysis (RIA) alongside the rule that reflects that substantial body of research and estimates the gains to investors and costs of the proposed rule.
- **The rule's substance has changed based on comments received since 2010. Specifically, the proposal:**
  - **Provides a new, broad, principles-based exemption that can accommodate and adapt to the broad range of evolving business practices.** Industry commenters emphasized that the existing exemptions are too rigid and prescriptive, leading to a patchwork of exemptions narrowly tailored to meet specific business practices and unable to adapt to changing conditions. Drawing on these and other comments, the best interest contract exemption represents an unprecedented departure from the Department's approach to PTEs over the past 40 years. Its broad and principles-based approach is intended to streamline compliance and give industry the flexibility to figure out how to serve their clients' best interest.
  - **Includes other new, broad exemptions.** For example, the new principal transactions exemption also adopts a principles-based approach. And DOL is asking for comments on whether the final regulatory package should include a new exemption for advice to invest in the lowest-fee products in a given product class, that is even more streamlined than the best interest contract exemption.
  - **Includes a carve-out from fiduciary status for providing investment education to IRA owners,** and not just to plan sponsors and plan participants as under the 2010 proposal. It also updates the definition of education to include retirement planning and lifetime income information. In addition, the proposal strengthens consumer protections by classifying materials that reference specific products that the consumer should consider buying as advice.
  - **Determines who is a fiduciary based not on title, but rather the advice rendered.** The 2010 rule proposed that anyone who was already a fiduciary under ERISA for other reasons or who was an investment adviser under federal securities laws would be an investment advice fiduciary. Consistent with the functional test for determining fiduciary status under ERISA, the proposal looks not at the title but rather whether the person is providing retirement investment advice.
  - **Limits the seller's carve-out to sales pitches to large plan fiduciaries with financial expertise.** This responds to comments that differentiating investment advice from sales pitches in the context of investment products is very difficult and, unless the advice recipient is a financial expert, the carve-out would create a loophole that would fail to protect investors.
  - **Excludes valuations or appraisals of the stock held by employee stock ownership plans (ESOPs) from the definition of fiduciary investment advice.** The proposed rule clarifies that such appraisals do not constitute retirement investment advice subject to a fiduciary standard. DOL may put forth a separate regulatory proposal to clarify the applicable law for ESOP appraisals.