

## Flawed Regulatory Impact Analysis Caused Labor Department to Miss the Mark with Fiduciary Rule

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By Brian Reid

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Testifying last month about the Department of Labor's proposed rule to redefine what types of interactions in the retirement market create a fiduciary relationship, Labor Secretary Thomas Perez told a Senate subcommittee about the proposal's "North Star — an enforceable best-interests commitment" for brokers and other retirement services providers.

As the DOL holds hearings on the rule this week, I hope it will recalibrate its compass.

The mutual fund industry agrees with the principle of requiring financial advisers to act in their clients' best interests when offering personalized investment advice. Unfortunately, DOL has gone astray in trying to reach that goal. Knowing your destination isn't enough to get you there.

The crux of the proposal is a definition of fiduciary so broad and so imprecise that it perversely would cut retirement savers off from ordinary interactions with call-center representatives and information on websites. A proposed exemption from the rule's onerous prohibitions, designed to let investors continue to pay for advice through broker commissions — often the least expensive option — would require brokers to navigate an impossibly complicated minefield of compliance traps. Even the brokers' front-line regulator, the Financial Industry Regulatory Authority Inc., calls DOL's rules misguided and confusing.

What has led DOL so far off course? The answer lies in large part in how it has tried to justify the rule — with a deeply flawed regulatory impact analysis asserting a "substantial failure of the market for retirement advice."

The analysis argues that brokers who are paid commissions on mutual funds with front-end loads offer "conflicted advice" that steers retirement savers into expensive, underperforming funds. A White House study claims that fund investors lose \$17 billion a year to this "underperformance." The DOL claims that if its rule is not implemented, retirement savers stand to lose \$430 billion over the next 10 years—and nearly \$1 trillion over the next 20.

The evidence debunks all of these claims. A few simple tests of fund sales, fees and performance since 2007 disprove the regulatory impact analysis's claim of "market failure" in retirement savings. Brokers are in fact helping retirement savers find funds that cost less and perform better than the average for similar funds.

One test wipes out nearly all of DOL's rationale. It shows that retirement savers who own funds with front-end loads have concentrated their assets in funds that outperformed — not underperformed, as the DOL asserts — the average return for their Morningstar category by 27 basis points, net of expenses.

The average fund with a front-end load, meanwhile, has outperformed its Morningstar category average by 13 basis points. If anything, brokers seem to be guiding their clients to funds that slightly outperform, not underperform, the average front-end load fund.

A second test shows that — after adjusting for 12b-1 fees, which are paid to brokers for investor services — investors in funds with front-end loads reap nearly the same return as investors in funds with no load at all. The difference is a mere 7 to 8 basis points — a far cry from DOL's claim that broker-sold funds underperform by 100 basis points.

A third test shows that investors in funds with front-end loads concentrate their purchases in funds that pay brokers below-average loads, the opposite of what one would expect if brokers were steering investors into funds that pay higher loads. A fourth shows that

investors in funds with front-end loads generally are paying expenses to operate their funds near those paid by investors in funds with no sales load.

As DOL participates in this week's hearings — and continues to work its way through the many comments, most of them opposed to its proposal — it would be wise to take these findings into account. Retirement savers investing with brokers aren't suffering from underperformance or excess charges — they're investing in less expensive, better-performing funds, as more and more investors continue to do.

Secretary Perez promises that DOL will be “flexible” in getting to a final rule. That's welcome news — but that flexibility must entail fundamentally reassessing the DOL's regulatory impact analysis. Though many paths could lead the DOL to a best-interest standard, the right path cannot begin with a false claim of market failure — and it cannot end with restricting retirement savers' access to the information and advice on which they depend.

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