About That White House Memo on IRAs

By Kerry Pechter *Thu, Jan 29, 2015*

A memo on White House letterhead dated January 13 has rekindled both hopes and fears that the Department of Labor might soon re-propose restrictions on the kinds of transactions that advisors and brokers can recommend to IRA owners.

Just when ERISA watchers were ready to assume that the Department of Labor would *not* reissue its 2010 proposal on prohibited IRA transactions before time expires on the Obama administration, a leaked White House **memo**—or fragment of one—raised expectations that a re-proposal might emerge very soon.

"I think it's fair to say that the DOL now has the support of the White House on the fiduciary re-proposal," ERISA lawyer Fred Reish told *RIJ* this week. "Regardless of anyone's views on the merits of the rule, I believe this means that we will have the proposal in short order."

Printed on White House letterhead and written by economists Jason Furman and Betsey Stevenson of the president's Council of Economic Advisors, the memo "lays out evidence that consumer protections in the retail [IRA] and small [401k] plan markets are inadequate and the current regulatory environment creates perverse incentives that ultimately cost savers billions of dollars a year."

The financial services industry was said to be "apoplectic" about the memo. Possibly irritated by the memo's use of freighted words like "perverse" and "churn," one industry executive responded publicly and in kind. "The ignorance in the memo is shocking to me," said Adam Antoniades, chairman of the Financial Services Institute and president of Cetera Financial Group, according to a report in *ThinkAdvisor*. "For those who spend their lives in the industry, it is frankly offensive."

The memo, published in *The Hill*, doesn't include any fresh details about the anticipated DoL re-proposal, however. Instead, it "provid[es] background on the potential Conflict of Interest Rule for Retirement Savings." The seven pages that were leaked included estimates of the alleged cost to savers of current distribution practices, as well as summaries of efforts by other countries to regulate conflicts of interest in retail financial services.

ERISA law is byzantine, but the crux of this issue seems to involve "exemptions from prohibited transactions." Nine years ago, for instance, the DoL's Employee Benefit Securities Administration (EBSA) published **Advisory Opinion 2005-23A**, which said "No" to the question: "Would an advisor who is not otherwise a plan fiduciary and who

recommends that a participant withdraw funds from the plan and invest the funds in an IRA engage in a prohibited transaction if the advisor will earn management or other investment fees related to the IRA?"

In 2010, following the 2008 switch to a Democratic from a Republican administration, EBSA issued a new proposal that would reverse at least part of 2005-23A, so that the answer to the question above would be or might be "Yes." There's a lot more to the proposal, but that's one of the sensitive points. Changing "No" to "Yes" might keep some brokers from executing transactions in the retail IRA business.

Today, that's a humungous business—and one that nobody foresaw or intended and whose governance was not well thought-out. As 401(k) participants change jobs and retire, many of them move money to rollover IRAs at broker-dealers or to fund companies like Vanguard, Fidelity, or Schwab, or to discount brokers like E*Trade, or TD Ameritrade. Over time, some $6 trillion in 401(k) assets has rolled over to IRAs. Competition for even a small a piece of that giant pie is intense.

But the Obama administration, and specifically EBSA chief Phyllis Borzi, sees those tax-deferred accounts as moving from a safe (think: convent) to a dangerous (think: casino) environment when they go from a highly regulated 401(k) to a loosely regulated retail IRA. They lose the fiduciary standard of conduct and the low fees of 401(k) plans. They can be steered into investments or uses that, in EBSA's view, are too expensive or too risky for retirement accounts.

The nuances of the proposal, like other pension regulations, are subtle and the language tends to loop around in mind-numbing double-negatives ("Exemption from prohibited" means permissible). But the big picture may be simple: The financial services industry recognizes a bonanza in that $6 trillion IRA rollover market and the government—or rather, members of the Obama administration—want to make it less of a bonanza by banning conflicted transactions when tax-deferred money is involved.

Is abuse of the advisor/broker ambiguity the exception or the rule? Reasonable people strenuously disagree. The securities industry, I believe, fails to understand that, because of tax deferral, the government has a reasonable obligation to make sure that rollover IRA money receives more conservative handling than other retail money. The government, I think, fails to understand the web of incentives that drive the investment industry, and the difficulty of distinguishing the perverse from the benign. For instance, many (but not all) of the firms or people who go into the arduous, low-return retirement plan business do so in

anticipation of much their real profits when the money rolls over to retail IRAs. One person's conflict of interest is another person's synergy.

The leaked memo could be a red herring. Lots of position papers circulate in the White House. This might be just one of many straws in the wind. A senior financial services executive told *RIJ*, "We've been told that this was a leaked memo that was for internal purposes only, therefore it does not represent the current position of the White House."

Even if the re-proposal were submitted to the Office of Management and Budget (OMB) for review tomorrow, it would still have a long row to hoe. "Once it's there, it could take anywhere from weeks to three months (or even more) to get cleared and published in the federal register," Reish told *RIJ*. "That will start a comment period of anywhere from 30 to 60 days. My suspicion is that it will be on the lower end of that since this thing has already been commented on twice before and… the comments will be similar on both sides. Then the DOL will go to work on a final regulation. I suspect the final will go to the OMB before the end of the year, [with] a final regulation in place by summer of 2016."