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## Do Fiduciary Rules Work, or Do They Backfire?

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By Kerry Pechter      Thu, May 30, 2019

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*'We found that broker-dealer representatives in states with common law fiduciary duties sold cheaper and better products and sell fewer variable annuities overall,' said Manisha Padi, one of the authors of a new paper exploring the impact of imposing fiduciary duties on advisors.*

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Using internal data from one of the nation's top five annuity issuers—its identity isn't revealed—analysts at Northwestern University and the University of Chicago try to resolve questions that arose during the recent battle over the Department of Labor's fiduciary rule but were never settled:

- If regulators required all commission-paid brokerage reps to meet a fiduciary standard of conduct when selling annuities (to retirement account owners, in the DOL's case), would the reps offer advice that was more client-friendly than before?
- Or would the regulation raise their compliance costs and increase their legal liability so much that they would exit the market?

In other words, would a fiduciary rule cleanse the vendor-financed annuity distribution model of its worst conflicts of interest, or would it backfire and drive an imperfect but worthwhile business model out of existence?

Despite the death of the Department of Labor's 2016 fiduciary rule (a casualty of the Trump victory in that year's presidential election), that question lives on. Individual states are pursuing their own versions of it, and economists Vivek Bhattacharya and Gaston Illanes at Northwestern and economist/attorney Manisha Padi at the University of Chicago recently conducted a [study](#) that they thought might, indirectly at least, provide some answers.

Using 2013-2015 annuity sales data from a large anonymous source ("within the top-five companies by market share in the market for annuities"), they analyzed the patterns of variable annuity (VA) sales by broker-dealer reps and "dually registered" advisors (registered investment advisors, or RIAs, with broker-dealer affiliations) in counties facing each other across the borders of neighboring states.

In each case, one state had fiduciary requirements for financial intermediaries but the adjacent state did not. The analysts hoped to use geographical differences in fiduciary standards to shed light on a change (i.e., before-and-after the 2016 DOL would have gone into effect) in fiduciary standards.

“The critics of the fiduciary rule argued that it would only change the cost of advice and the composition of firms selling annuities, and that it wouldn’t improve the quality of advice,” Padi told *RIJ* this week. “We found that broker-dealer representatives in states with common law fiduciary duties sold cheaper and better products and sell fewer variable annuities overall.”

They also found that the annuities that VA owners would receive (if they annuitized those contracts) had higher net present values, on average, than VA contracts sold in the states without fiduciary rules. As for the cause of the difference, they speculated that in states where “stockbrokers are recognized as having fiduciary responsibilities, where it’s easier for clients to sue them for misconduct, that the additional source of liability might affect the way they are trained and socialized,” Padi said.

“Fiduciary duty does not simply increase fixed costs,” they write. “We find that, in the market for annuities, fiduciary duty shifts the set of products purchased by investors away from variable annuities and towards fixed and fixed indexed annuities. We then focus on variable annuities and find that fiduciary duty leads broker-dealers to sell products with more investment options and higher returns.”

But the authors of the study do concede “that fiduciary duty causes exit of broker-dealers from the market, with the incidence most heavily slanted towards local broker-dealers.” That is, the added compliance costs associated with a fiduciary rule could cause brokerage firm consolidation.

“We find that imposing fiduciary duty on broker-dealers reduces the number of broker-dealer firms operating in the market by about 16%. Moreover, we document a compositional shift to not just investment advisory firms—whose number are not significantly affected by the regulation—but also to broker-dealer firms with larger footprints.”

The findings of the study are not conclusive. It’s never easy to gauge the consequences of new regulation; as with an organ transplant, the regulated industry might fight it instead of accepting it, even if it’s for the overall good of the body politic.

The annuity business in particular is extremely complex, and the authors don’t always seem to know what they don’t know about annuity products or distribution channels. “This is a working paper version and we will be incorporating feedback from industry experts,” Padi told *RIJ*.

But they had privileged access to high-quality, granular sales data, and seem to have a basis

for concluding that fiduciary rules don't necessarily backfire in the marketplace. These findings could become an important piece of evidence as individual states decide whether or not, in the absence of the issuance of a satisfactory uniform federal fiduciary standard, to establish or strengthen their own.

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