
Retirement Savings in a Co-Ed Dorm?

By Kerry Pechter *Fri, Nov 1, 2013*

The investment industry wants to benefit from the tax-deferral subsidy and charge whatever it likes on the subsidized money in rollover IRAs. That's asking for a lot. More important, it invites Uncle Sam to think about taking the subsidy away.

The securities industry's effort to outflank the Department of Labor's Phyllis Borzi made progress this week when the House approved the Retail Investor Protection Act of 2013 by a 254-to-166 vote.

But the law—which would help ensure that retail investors' rollover IRA assets are *not* protected by a fiduciary rule—is doomed. President Obama will never sign it. So why bother?

Because there's so much at stake, obviously.

The bill's sponsor, Ann Wagner (R-Mo), explained on C-SPAN that the DoL's fiduciary rule would reduce IRA owners' access to investment advisers. It would do the opposite. It would likely reduce brokers' access to rollover IRA assets and restrict their revenues from managing them.

Hence the industry's (understandable) outrage. Billions of dollars in security industry revenue may be riding on whether or not the DoL's fiduciary proposal becomes regulatory reality. (Personally, I doubt the DoL will win this one. Borzi, who is chief of the DoL's Employee Benefit Security Administration has the moxie, but not the muscle.)

If you're new to this topic, here's some background information. When someone saves through a 401(k) plan, the managers of that money are subject to the stringent rules of the Employee Retirement Income Security Act of 1974. ERISA requires the managers to act only in the participants' interests. Ideally, that means low fees, transparency and plain vanilla investments—not exactly catnip for brokers.

When 401(k) plan participants change jobs or retire, however, they can “roll” their tax-deferred savings from the 401(k) to a “rollover” IRA account. The money remains tax-deferred, but it moves outside the jurisdiction of ERISA.

The DoL proposal would apply ERISA-like standards to the tax-deferred rollover money. It would bar brokers who conduct themselves according to suitability standard from advising

on the disposition of that money.

That would be huge. Trillions of dollars in IRA rollover money would suddenly be off-limits to all of the registered reps and loosely-defined “investment advisers” (and their broker-dealers) who might otherwise steer retirement savings into actively managed funds or other products with high fees or commissions.

The DoL is afraid those fees will stunt retirees long-term accumulations. For regulators, plan participants who roll over their savings to IRAs are like young girls who move from their parents’ homes to rooms in co-ed dorms on wet college campuses. The DoL knows (and brokers know) that the broker-dealer world is a place where fools and their money are soon parted.

Yes, I understand the financial industry’s argument that, without help from brokers those IRA owners might hold cash for 20 or 30 years. There’s some truth to that. The industry also claims that if the DoL removes the existing incentives to advise middle-income investors—commissions, for instance—those investors won’t get any advice at all. There’s some truth to that too. If the costs and benefits of financial advice were more transparent or tangible, investors could probably decide these issues for themselves. But, as things stand today, most of them can’t.

Let’s ask the ultimate question: Does the DoL have any right to regulate the fees that the industry can assess on Americans’ rollover IRA assets? To answer it, we have to deal with the question of tax deferral, a government-given dispensation that helped make the retirement industry the leviathan that it is today.

To return to our college analogy: the father who’s paying his child’s tuition expects (or hopes, at least) that the college will act *in loco parentis* and keep a paternal eye on his child. Similarly, the current administration may imagine that Uncle Sam’s \$100 billion-a-year tax subsidy on retirement savings (only some of which will later be recovered through required distributions) allows it to expect some forbearance on the industry’s part with respect to the subsidized money, in the form of a fiduciary standard.

Paternalism? Absolutely. Justified? We could argue that one all night.

I don’t question the securities industry’s right to make a buck. I don’t even object to the principle of “buyer beware,” if the buyer is competent. But trying to “have it both ways” seems like overreach. The industry wants to benefit from the tax-deferral subsidy *and* charge whatever it likes on the subsidized money in rollover IRAs. That’s asking for a lot.

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