
Should ERISA regulations extend to rollover IRAs?

By Editor Test Mon, Apr 29, 2013

Americans move about \$300 billion from 401(k) plans to rollover IRAs every year. That's good for brokerage firms but it leads to higher fees and less protection for savers, a new study claims. (Pictured: Alicia Munnell of the Center for Retirement Research at Boston College.)

The elimination of 12b-1 mutual fund marketing fees, which add about 25 basis points to the cost of many funds and which can be used to incentivize broker-dealer reps to sell those funds, wouldn't help investors much, according to a new [study](#) from the Center for Retirement Research (CRR) at Boston College.

Instead, the study's authors recommend:

- Making it easier to retain accumulated assets in the 401(k) system.
- Making the rollover from a 401(k) to an IRA an ERISA-covered event.
- Extending ERISA to all rollover IRAs.
- Instituting changes to further control fees in both 401(k)s and rollover IRAs

The CRR study, "The Economic Implications of the Department of Labor's 2010 Proposals for Broker-Dealers," suggests that those proposals, which would have reclassified brokers as fiduciaries under the Internal Revenue Code and made them ineligible for the types of incentives funded by 12b-1 fees, didn't go far enough toward protecting investors who move their money from 401(k) plans to rollover IRAs.

The DoL withdrew its 2010 proposal in the face of resistance from the investment community and hasn't reissued it yet. The investment industry has maintained that eliminating revenue-sharing arrangements such as 12b-1 fees could force broker-dealers to charge investors directly and explicitly for advice, which could reduce demand for advice, possibly resulting in fewer investors receiving guidance.

According to the CRR study, 12b-1 fees are not a large percentage of brokerage revenue. Such fees amounted to \$9.5 billion for all mutual funds in 2009, with about 20% or \$2 billion of that attributable to IRA customers, the study said. But that may be only about one percent of the total brokerage revenue that comes from managing investor accounts.

"According to the SEC, total broker-dealer revenues in 2010 amounted to \$263.2 billion," of which about "\$55.6 billion came from trading gains and underwriting profits" and roughly \$200 billion from managing individual savings, the CRR study said. "Thus, the loss of 12b-1 fees for mutual funds in IRAs (\$2 billion) would amount to about 1% of their total (non-trading/non-underwriting) annual revenue (\$200 billion)."

Based on existing pricing and cost evidence from the United States and on the experience of ongoing reforms in the United Kingdom aimed at lowering fees and improving investment advice, the CRR analysis showed little effect from eliminating 12b-1 fees. The analysis showed that:

- Elimination of 12b-1 fees would reduce IRA customer costs by 4 basis points (.04%).

- IRA customers could save another 7 basis points if broker-dealers responded to the loss of 12b-1 fees by moving customers away from high-cost, actively managed funds into low-cost index funds,
- Broker-dealers would probably not change their business model with respect to the provision of advice if 12b-1 fees were eliminated.

The DoL's 2010 proposal was inspired in part by a concern that the friction of high fees on retail funds in rollover IRAs at broker-dealers—about \$150 billion went into advisor-managed IRAs from 401(k) plans in 2011, according to Cerulli Associates—would slow the accumulation of retirement savings. (Another \$150 billion moved from 401(k) plans to relatively low-cost rollover IRAs at discount brokerages in 2011.)

“As long as accumulations are held in 401(k) plans, participants are operating in a world in which sponsors must operate as fiduciaries and fees are under a spotlight. Once they roll over their accounts into IRAs, they enter a world where suitability becomes the standard of care and broker-dealers are paid commissions that encourage the sale of high-priced mutual funds,” wrote the CRR’s Alicia H. Munnell, Anthony Webb and Francis M. Vitagliano.

“If a fiduciary standard and attention to fees are appropriate for retirement assets when they are in the plan, such safeguards are clearly still appropriate when they are rolled over. The DOL recognizes this logic, but, with its authority limited to defining who is a fiduciary under the Internal Revenue Code, has put forth a very modest proposal.”

The 12b-1 fee was first added to mutual fund expense ratios as a way for fund companies to cover their marketing costs. The fund companies claimed that it was appropriate to pass such costs along to existing shareholders because the economies of scale achieved through new sales would lead to a reduction in overall fund expenses.