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THE CURRENT: What does new rule on financial advice mean for retirement security?

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PITA: You're listening to the current part of the Brookings Podcast Network. I'm your host, Adrianna Pita. On Tuesday, the Department of Labor released a new proposal, what they're calling the Retirement Security Rule, or sometimes referred to as the fiduciary rule, aimed at more strictly regulating financial advisors who give investment advice to retirement savers. With us to discuss the new proposal and what it means for people seeking advice about their retirement plans is Ben Harris, vice president and director of Economic Studies and director of the Retirement Security Project here at Brookings and previously assistant secretary for economic policy and chief economist at the Treasury. Ben, thanks for talking to us.

HARRIS: Thanks for having me on.

PITA: So, start us off right at the very top. What is this new retirement security rule and what is it trying to do?

HARRIS: So, it might be helpful to start with a little bit of background. The law that is effectively governing this rule is known as ERISA, which is an incredibly important rule that was put in place in 1975 and basically set the landscape for retirement products and retirement advice. But a lot has happened in the retirement landscape over the past 50 years. And I think one of the most important things is has happened has been that savers have migrated from defined benefit pensions, which are traditional pensions, where you work for an employer and they give you a set amount of money every year for the rest of your life, and towards accounts that look more like 401Ks, which we call defined contribution accounts.

Now, one of the big differences between pensions and 401K-like accounts are that 401K-like accounts are managed by the worker, or the saver, or the individual, which requires a fair amount of knowledge in terms of how to invest and financial decisions that need to be made. And so, when that type of onus is put on the saver, you know, a lot of times people are not experts in this field, so they turn to experts. And so, what this ultimately is doing from a very high level is updating the laws governing retirement investment advice to be more consistent with the landscape today, to be more consistent with a retirement landscape where people have to make their own individual decisions and are turning to advisors for advice. This is something that people didn't have to do 50 years ago when ERISA was passed.

So specifically, what does the law do? It does a few things. One is that it includes more types of products under the umbrella that demands a certain level or a certain standard of advice. And so, what are the products that it includes? So, the headline product, if you look at the information coming out of the White House, is around annuities. And so annuities typically are not covered under this umbrella that demands that people receive a certain level of advice. So, for example, if you're a saver and you go to an investment adviser and you're looking for advice about which mutual fund to purchase, that decision, the mutual fund advice is generally covered, but annuities are not. So, products are under this rule, certain products like annuities or commodities are included in the type of products where you can expect to receive a certain level of advice.

The second thing that it does is update the instance, the relationship between the saver and the adviser that might be covered. And the big difference by my reading -- and I should say this is a 500-page rule that came out yesterday, so I haven't had as much time as I would like to digest it -- but my reading of it is that a big thing that has changed is around one-time advice. And so, under the current regulation, prior to this rule, a person might go to an adviser at the period of a rollover. So, you have saved for your whole life in a 401k, maybe you’re at one job, maybe many. But let's say that you're at the end of your career and you're making a decision about what to do with your accumulated retirement savings. And you go to a retirement adviser and you're saying, look, I want to put this in some type of product. Now, under the current regulations, if you're just going in for one-time advice, that might not be covered under this umbrella rule that demands you get a certain level of advice. And what this does is it says that if the adviser provides regular advice, not just to you, but as part of their course of business, then they might be subject to a fiduciary standard. So, what it ultimately does is protect people who are looking for that, you know, one-time piece of advice from an adviser around rollovers.

The third thing that the law does is around and includes decisions made by plan sponsors. So, this is basically the employer. So employers often maintain 401Ks, they have to make decisions as far as what investments to leave in and what investments to take out, ultimately what investments to offer the employees. And so that type of advice around what menu to present to your retirement savers, that's now included under this umbrella that demands a certain level of standard.

PITA: Okay. Isn't this very similar to something that the Obama administration tried to do back in 2015, 2016? Whatever happened to that?

HARRIS: Yes. So this this area has a very active history. So in 2016, with a great deal of effort by staff in the Obama administration -- and I had two stints in the Obama administration -- the Department of Labor came out with what was known as the fiduciary rule, and that was ultimately struck down in courts as being overly broad. Then in 2019, the SEC came out with its own rule known as REG BI or REG best interest. Now, I think it's important to know that both DOL and SEC have different jurisdictions. And so the SEC rule applied to decisions around purchasing products like mutual funds, but like I said earlier, left out things like annuities which are not covered under the SEC umbrella. So you had the 2016 law was struck down. The 2019 regulation is still in place, but it's not especially broad and not especially binding in certain circumstances. So what the Department of Labor was really trying to do was fill in some of the holes left by the 2016 law that was struck down in court.

Now, you could ask, well if it was struck down in court, what makes it plausible now? And the first thing I should say is this is just a proposed rule. So there will be a period of about 60 days in which stakeholders can submit comments, and there may be a chance that the rule is adjusted before it's finalized. Secondly, it’s less broad than the 2016 law, the retirement rule that was rolled out yesterday. The 2016 law effectively applied to any time anyone was providing retirement advice to savers. It was incredibly broad and it was ultimately any conversation that you had with an advisor would be covered. This is much more narrowly targeted to certain products and targeted towards that one-off type of advice you might receive around the rollover instance. So it’s more narrow.

PITA: If it is more narrow, what are some of the objections to it? Is it likely to face some similar types of challenge, even if it's not exactly the same?

HARRIS: Yeah, I think it's virtually sure that you'll see a lawsuit filed against it. And I think the claim by industry is that it's overly stringent, and what this means is that advisors will drop out of the market. And that was a similar claim that industry was making in 2016. I didn't find it terribly compelling at the time, in part because, as a saver, if you spend your whole life accumulating savings and you're going to someone for advice, and you're paying them for that advice, you're expecting that the advice they give you is in your own best interest. And this is a really important decision. I mean, it's a literally a lifetime of saving that's on the line here. And so, I felt like the academic evidence and the projections suggesting that people would drop out of the market, that advisors would drop out of the market owing to the fiduciary role in 2016 probably wasn't all that well-founded on the evidence. It's true that some commissions might go down or they'd have to be paid differently, but I didn't feel like there would be this overwhelming dearth of investment advice in the market. It still felt like a plausible business model. So I think you'll see similar arguments raised here, which is which is basically focused on exits from retirement advisors from the market, potentially leaving low- and middle-income savers with no advice. Now, if that happens, I think it's a legitimate complaint. I just don't think will happen.

PITA: Talking about who this applies to and sort of the realm of the American worker writ large, a recent CNBC article had cited a report that said that 62% of Americans are living paycheck to paycheck. What are some of the other tools that either are or that you think maybe ought to be being considered to help improve Americans' bigger picture of retirement security, given how not a lot of people are investors, right?

HARRIS: Yeah.

PITA: So how do we help everyone?

HARRIS: Yeah. So I think there's two big areas which the Biden administration can address moving forward. The first would be a fleshing out of a campaign commitment that the president made while he was a candidate in the 2020 election. I should say for full disclosure, I was an economic adviser to the Biden campaign. And so one of the commitments the president made was to make saving incentives more equal. If you do a deep dive on the distribution of saving incentives for American savers, you see that they're mostly concentrated at the top. So, in any given year, you have about $250 billion in foregone tax revenue or tax breaks given to people who are putting money in a 401K or an IRA, but the vast majority of that is concentrated around the top fifth of savers. So, if you're making 30, 40, 50, $60,000 a year, the benefit of saving in a 401K is going to be pretty limited. And there's no reason why you can't distribute that $250 billion in benefits in a more equal way, with, I would say, tweaks to the 401K system. So I'd love to see that fleshed out, proposed -- that has to be legislated, that can't be regulated. But you know, I think the first step would potentially be a budget proposal around that.

The second area that I think the administration can do more work in is around the de-cumulation stage of retirement saving. By that I mean the spend down part of retirement. And right now, we have really good tools for accumulating retirement saving. Yesterday's announcement was a step towards improving investment advice and will hopefully improve the landscape for that. But in general, we just have fairly widespread 401Ks, we're moving towards a system of automatic enrollment where people are automatically put on the path towards good saving. People own houses which are a saving vehicle in and of themselves. But we don't have a great system for spending down those assets once you get to retirement. And I would love to see a greater focus on things like reverse mortgages. Now, reverse mortgages don't have a great reputation, but they're a product which could be appealing for a subset of people who are house rich and financial-asset poor. So think of, for example, a 65 year old who wants to retire, who maybe has $400,000 in their home, but only $30,000 in liquid savings. What do you say to that person? They're not poor. They have half a million dollars roughly in assets. And so reverse mortgages are products which can help that person spend down or access some of the equity they have in their home without actually having to leave their home. And we know that retirees love staying in their homes, by and large, unless they have to move. And so, we can see better policy made around reverse mortgages. We can see better policy made around long-term care insurance. We could see better policy around annuities, not just the advice around whether to purchase an annuity like we saw yesterday, but particularly providing some support for employers who want to offer their workers annuities in their plans, which I think is a really important first step towards seeing better take-up of annuities. So those are the two areas where I'd love to see a little more attention from the Biden administration.

PITA: All right. Well, Ben, thanks very much for talking to us and explaining this today.

HARRIS: Thanks for having me.