



Q&A on Small Savers

Q1: Who are small IRA savers?

Small IRA savers may not be who you think they are. More than two thirds of small-IRA owners are wealthy and upper-middle-class households for whom these IRAs generally represent only a single component of a larger financial portfolio. Households in the lower half of the income distribution account for just under a third of small IRA ownership, as these households are much more likely to save for retirement via job-based plans.

Small savers in the IRA market are households that own IRA accounts but whose IRA assets are only modest in value. The composition of this group, however, may not line up with what many people envision when they hear the term “small saver.”

The majority of small IRA accounts do not actually belong to low-income workers and families, but instead belong to wealthy and upper-middle-class households. Roughly 70 percent of all non-elderly households that own small IRAs – defined here as those worth less than \$25,000 – are in the top half of the income distribution.ⁱ In fact, nearly 38 percent are in the top quarter of all earners.ⁱⁱ These are households that generally own their own homes as well as other types of financial assets such as job-based defined-contribution plans, stocks, and mutual funds.ⁱⁱⁱ

Many lower- and middle-income workers and families often struggle to find money to save for retirement at all, and when they do save it is primarily through job-based plans such as 401(k)s. Only 10 percent of households in the bottom half of the income distribution own any IRA assets, compared to 25 percent who have assets in a job-based plan.^{iv} Those in the bottom half of the income distribution account for less than a third of all non-elderly households that own small IRAs, but it is these middle- and working-class families that are the small savers most at risk from conflicts of interest due to their reduced ability to absorb financial losses and because the process by which they generally enter the IRA market – rolling over funds from job-based plans – is very vulnerable to conflicts of interest.^v

Q2: How do conflicts of interest impact low- and middle-income small savers?

Low- and middle-income small savers are especially vulnerable to conflicts of interest because they are least able to absorb the costs of hidden fees and lower returns. Most of these households also enter the IRA market via rolling over savings from job-based plans – a process during which they can easily be exposed to conflicted advice.

All savers – whether large or small – can lose money due to conflicts of interest, but low- and middle-income small savers are particularly vulnerable to the negative impacts of conflicted advice. These savers can least afford to lose a portion of their savings to hidden fees or diminished investment returns. No one should have to watch a portion of their hard-earned nest egg be eaten away by conflicted advice, but particularly for savers with limited resources, these losses can have a real and significant impact on their ability to achieve economic security in retirement.

Additionally, when low- and middle-income workers and families do enter the IRA marketplace, they overwhelmingly do so via a process that is particularly vulnerable to conflicted advice: rollovers. Most of the money these families invest in IRAs comes from rollovers from job-based plans, as it is through these plans that small savers do most of their saving.^{vi} Rolling over these life savings can be among the most important financial decisions that many consumers make regarding their retirement security, but right now many retirement investment advisers do not have to adhere to fiduciary standards when giving rollover advice. This means their advice does not have to be in the saver’s best interest.

Q3: How do low- and middle-income small savers receive advice in the existing IRA market?

The current financial advice marketplace is not one in which low- and middle-income small savers are frequently provided the types of detailed personalized financial advice many envision when they think of advice provided by professional advisers. Most of these small savers already turn to other sources for advice, many of which are lower cost.

The current marketplace for financial advice is not one in which low- and middle-income small savers are frequently receiving the types of full-service personalized financial advice that many may imagine when they hear the terms “financial advice” or “professional adviser.” Individuals with only \$50,000, \$25,000, or lower amounts to invest are generally not offered these services by many large investment firms, which can have account balance minimums in the hundreds of thousands of dollars.^{vii} These larger companies often steer these investors instead to call centers or online services.^{viii}

Surveys also help illustrate that many small savers of modest means do not appear to receive full-service personalized advice from professional advisers but instead frequently turn to other lower-cost options. Data from the Survey of Consumer Finances show that very few households with low incomes or small IRAs seek financial advice from brokers, with far larger shares looking for advice from friends or relatives, bankers, and the internet. Among non-elderly households that fell in the bottom 25 percent of earners, only 4 percent reported turning to brokers for financial advice, while 43 percent turned to friends or relatives, 32 percent turned to bankers, 28 percent looked online, 15 percent sought advice from financial planners, and even smaller shares sought it from print media or television and radio.^{ix} Even when looking at all owners of small IRAs – whether they are low-, middle-, or upper-income – only 15 percent seek financial advice from brokers.

What these facts illustrate is that low- and middle-income small savers generally do not receive the types of detailed personalized advice that many envision when they think of financial advice. While less-intensive and lower-cost forms of advice may actually make sense for many of these families given their simpler portfolios, it is important to understand that the status quo is not one in which these small savers are frequently being provided full-service professional advice, and that the

limited number of small savers that do participate in the IRA marketplace are generally turning to other lower-cost options for guidance on what to do with their investments.

Q4: Will small savers still be able to receive retirement and investment education under the new rule?

The proposed rule clearly allows for all savers to still be provided retirement and investment education and will not limit the amount of education available. The additional clarity the rule brings to the distinctions between education and advice will help improve the quality of the advice that savers receive.

The proposed rule explicitly makes clear that general retirement and investment education can be provided to all savers – whether large or small – without triggering any fiduciary responsibility. This education can include information on things like the importance of saving, how retirement plans work, and how the mix of investments a person owns should change as they age. Education can also include information on how to assess a person’s risk tolerance, historic differences in rates of return between different types of investments, and how to estimate how much income a person will need in retirement among many other things. None of this will trigger any fiduciary responsibilities on the part of the adviser as long as they do not make any suggestions about specific investment strategies or specific stocks, mutual funds, or other assets the saver should invest in.

The proposed rule also seeks to provide greater clarity on the line between education and advice than existed before, so that savers, advisers, and plan sponsors can be more certain of where one ends and the other begins. In particular, the new rule will help clarify where this boundary lies when it comes to advice and education concerning rollovers and distributions. By helping more advisers understand these distinctions, the Department believes the proposed rule will increase the quality of the education provided to savers which in turn can help them make more well-informed financial decisions. Such high-quality education can be particularly beneficial to low- and middle-income small savers who have less financial experience and may be less familiar with the investment landscape.

Q5: Will the new rule prevent advisers from providing financial advice to small savers?

The proposed rule will not prevent advisers from providing financial advice to small savers. Advisers will still be able to deliver advice to all savers and charge for the costs of the advice delivered -- the only difference is that this advice must now be in savers' best interests.

The proposed rule in no way prevents advisers from providing financial advice to small savers, and the rule is purposefully designed to provide advisers with significant flexibility in choosing the business model that allows them to best serve their clients.

First, under the proposed rule, advisers can still continue to provide advice in the way that many traditionally have when serving small clients: charging commissions based on investment recommendations and participating in revenue sharing. The proposed rule simply requires that recommendations be in savers' best interests and that advisers put in place policies and procedures that mitigate the impacts of conflicts of interest. Firms are also free to set up other fee arrangements and to continue serving clients via fee-based accounts as well.

To be clear, there is nothing in the proposed rule that prevents firms from charging clients for the costs of providing advice. The only difference is that clients will now be able to trust that the advice they are purchasing is in their best interests and will be better able to know what they are paying for it. This will enable them to make more informed decisions about what services and investments are appropriate for them and their families.

The Department also anticipates that this rule will help encourage further development of low-cost advice solutions that provide savers with the level of advice that best suits their needs.^x Many small savers with simple investment portfolios do not need complex, high-cost investment strategies, but would be better served by straightforward low-cost advice they know they can trust. Tremendous innovation has already been made in this area, with more and more advisers (including Certified Financial Planners) committing to a best interest standard and technological advances helping to drive down the price of providing basic quality financial advice to millions of savers.^{xi} Going forward, these technology-based models will be an excellent option for some and a support and supplement to traditional advice – which will continue to be available under the proposed rule – for others.

In sum, the proposed rule allows advisers significant flexibility when it comes to providing advice to savers of all kinds as long as the advice being provided is in the savers' best interests. Given that they can still provide and charge for advice, the Department believes it unlikely that the financial services industry will walk away from the billions of dollars held in small IRAs – in 2013 IRAs with less than \$50,000 in assets collectively held over \$265 billion in assets^{xii} – and the billions of dollars in potential rollovers small savers currently hold in job-based plans simply because advisers must take steps to make sure the advice they are selling is in clients' best interests.

Q6: How will small savers benefit from the new rule?

The proposed rule will benefit small savers first and foremost by helping them realize higher investment returns both before and after fees. It may also encourage more of them to seek out investment advice by enabling them to build up trust in financial advisers and could potentially increase their access to quality investment options.

As with all savers impacted, the most significant benefit small savers will see from the proposed rule will come in the form of increased investment returns as they receive advice that is in their best interests and that helps them invest in ways that are the most sensible for them and their families. In particular, because most small savers enter the IRA market via rolling over their savings from job-based plans, they would benefit from the protections provided by the conflict of interest rulemaking at the point of rollover. The Council of Economic Advisers has estimated that every year conflicts of interest cost IRA savers roughly \$17 billion in forgone returns.^{xiii} Returning any portion of this money to the pockets of low- and middle-income workers and families could go a long way toward improving their long-run financial health.

The Department also believes the proposed rule may actually lead more small savers to seek out financial advice, as they will be able to trust that the recommendations they are receiving are being provided to them with their best interests in mind.^{xiv} A 2014 survey sponsored by financial services organization TIAA-CREF found that when asked about obstacles to getting good advice, 64 percent of respondents said that it was hard to know what sources can be trusted – a larger share than pointed to any other obstacle.^{xv} Research utilizing focus groups and surveys has also shown that investors identify trust as the most important quality when seeking out professional financial advisers and that financial

trust is correlated with both the usage of advice and the likelihood of seeking out professional advice.^{vi} Being able to build up this kind of trust in advisers will not only help many small savers with limited financial experience navigate the market more comfortably, but it will also help the institutions that serve them gain clients and establish long-lasting mutually beneficial client relationships.

Finally, the proposed rule will also make it easier for financial advisers that do provide quality impartial advice to compete in the marketplace, which will in turn make it easier for small savers to seek them out and make use of their services.^{vii} While many companies have already

realized that there is good money to be made in providing small savers with transparently-priced impartial advice, currently these firms must compete against advisers who claim their services are “free” but who then collect money from savers via hidden fees and opaque backdoor payments. By leveling the playing field and ensuring that all advisers must openly disclose how they are being compensated for their advice and provide only advice that serves clients’ best interests, the rule will help both small savers and the firms already providing them with the types of advice that are actually beneficial to them.

Endnotes

i U.S. Department of Labor, “Fiduciary Investment Advice - Regulatory Impact Analysis,” April 14, 2015, available at <http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf>. Note that ‘non-elderly’ refers here to households with a head under the age of 65. Note also that all figures derived from the Survey Consumer Finances are from 2013, as this is the most recent year for which data are available.

ii Ibid.

iii Ibid.

iv Ibid.

v Ibid.

vi Ibid.

vii For examples of larger financial services firms having high minimum account balances and generally not providing full-service professional financial advice to smaller accounts see Matthias Rieker, “Some Advisers Tap Potential of Small Accounts,” *The Wall Street Journal*, June 23, 2014, available at <http://www.wsj.com/articles/some-financial-advisers-tap-potential-of-small-accounts-1403529872>; Ron Lieber, “Financial Advice for People Who Aren’t Rich,” *The New York Times*, April 11, 2014, available at <http://www.nytimes.com/2014/04/12/your-money/start-ups-offer-financial-advice-to-people-who-arent-rich.html>; Michael Wursthorn, “Merrill Lynch’s Brokers Want an Edge,” *The Wall Street Journal*, May 5, 2015, available at <http://www.wsj.com/articles/merrill-lynchs-brokers-want-an-edge-1430832419>; Evelyn Juan, “Firms Push Call Centers,” *The Wall Street Journal*, March 2, 2009, available at <http://www.wsj.com/articles/SB123549387374860649>.

viii For examples of firms pushing small accounts to use call centers and online services see Ibid.

ix U.S. Department of Labor, “Fiduciary Investment Advice - Regulatory Impact Analysis.”

x Ibid.

xi For an example of the adoption of best interest standards, see Certified Financial Planners Board, “CFP Board Adopts Revised Ethical Standards for Certified Financial Planner Professionals,” May 31, 2007, available at <http://www.cfp.net/news-events/latest-news/2007/05/31/cfp-board-adopts-revised-ethical-standards-for-certified-financial-planner-153-professionals>.

xii Authors’ calculations using data from Constantijn W.A. Panis and Michael J. Brien, “Financial Asset Holdings of Households in the United States: 2014 Update,” Deloitte (2014), available at <http://www.dol.gov/ebsa/pdf/conflictsofinterestreport3.pdf>.

xiii Council of Economic Advisers, “The Effects of Conflicted Investment Advice on Retirement Savings,” 2015, https://www.whitehouse.gov/sites/default/files/docs/cea_coi_report_final.pdf. For additional estimates of the monetary benefits of the proposed rule, see U.S. Department of Labor, “Fiduciary Investment Advice - Regulatory Impact Analysis.”

xiv U.S. Department of Labor, “Fiduciary Investment Advice - Regulatory Impact Analysis.”

xv TIAA-CREF, “TIAA-CREF Survey: More Americans Interested in Seeking Financial Advice,” September 9, 2014, available at <https://www.tiaa-cref.org/public/pdf/C19112SeptemberAdviceSurveyExecutiveSummary.pdf>.

xvi Angela A. Hung et al., “Investor and Industry Perspectives on Investment Advisers and Broker-Dealers,” Rand Corporation (2008), available at http://www.rand.org/content/dam/rand/pubs/technical_reports/2008/RAND_TR556.pdf; Jeremy Burke and Angela A. Hung, “Trust and Financial Advice,” RAND Labor & Population Working Paper 1075 (2015), available at <http://www.dol.gov/ebsa/pdf/conflictsofinterestreport5.pdf>.

xvii U.S. Department of Labor, “Fiduciary Investment Advice - Regulatory Impact Analysis.”