MEMO# 35817

September 5, 2024

GAO Report on Conflicts of Interest between Fiduciaries and Investors

[35817]

September 05, 2024

TO: ICI Members
Pension Committee
Pension Operations Advisory Committee SUBJECTS: Pension
Tax RE: GAO Report on Conflicts of Interest between Fiduciaries and Investors

The US Government Accountability Office (GAO) recently published a report focused on conflicts of interest between fiduciaries and investors.[1] As detailed below, the Report recommended that the Internal Revenue Service (IRS) implement an audit process for IRA fiduciaries to better identify those fiduciaries who engage in prohibited transactions.

The Report was commissioned at the request of Senators Patty Murray (D-WA) and Bernie Sanders (I-VT), and Representative Robert Scott (D-VA). According to GAO's highlights, GAO was asked to assess where issues around conflicts of interest and investment advice stand today. The Report examined the following:

- The changes industry reported making to address DOL's 2016 fiduciary rulemaking;[2]
- Conflicts of interest that can affect retirement investors, how they are communicated to investors, and their association with investment returns; and
- The extent to which federal regulators oversee conflicts of interest and actions that could potentially improve their oversight.

GAO performed its work from November 2020 through July 2024. To evaluate changes in response to the 2016 fiduciary rulemaking, GAO conducted interviews with, or received written responses from, 15 associations of financial professionals associated with the following groups—registered investment advisers (RIAs), broker dealers (BDs), insurance firms, retirement plan sponsors, and fiduciary compliance firms. GAO evaluated the impact on investors of conflicts by reviewing Form ADV filings submitted to the SEC by RIAs, conducting undercover calls to investment professionals at several different firms while posing as retirement investors, and performing a regression analysis of industry data to assess the association between financial incentives paid to firms whose financial professionals recommend mutual funds and mutual fund performance. Lastly, GAO assessed the work of regulators and potential improvements that could be made through interviews with personnel at DOL, IRS, SEC, and FINRA; and interviews with other relevant stakeholders including ERISA lawyers, behavioral economists, consumer advocates, academics, industry stakeholders, and fiduciary compliance professionals.

GAO stated the following conclusions, among others:

- Conflicts of interest disclosures are not clear for investors, who may not review or understand the documents made available to them;
- Mutual funds that compensate advisors who sell their funds are associated with lower investment returns (based on an analysis of Morningstar mutual fund performance data over the 2018−2021 period);[3] and
- Fiduciary oversight of IRAs by regulators is not strong enough.

Specific to regulatory oversight, GAO found that IRS does not have a process to identify prohibited transactions of firms or financial professionals who are fiduciaries to IRAs. Instead, IRS relies on self-reporting by IRA fiduciaries and on referrals from DOL where DOL identifies something incidental to an employer plan examination (DOL lacks authority to audit IRAs for prohibited transactions).

GAO made two recommendations to help IRS reduce conflicts of interest in advice provided as to IRA accounts.[4]

1. "The Commissioner of the IRS should develop and implement a process independent of DOL referrals for identifying non-exempt prohibited transactions involving firms or financial professionals who are fiduciaries to IRAs and assessing applicable excise taxes. For example, IRS could check Form 5330 filing compliance during income tax audits of financial services firms."
2. "The Commissioner of the IRS should coordinate with DOL through a formal means, such as a memorandum of understanding, on non-exempt prohibited transactions involving firms and financial professionals who are IRA fiduciaries and owe excise tax."

IRS agreed with GAO's recommendations, and stated it would explore ways to improve its efforts on both items.

While not a formal recommendation, GAO also observed that DOL could improve the information that financial professionals have as to employer plan investment options to enable them to better advise clients about IRA rollovers. Noting that industry representatives indicated that financial professionals cannot always easily access plan investment option information from available sources, GAO observed that the 2021 proposed revisions to Form 5500 Schedule H asset categories and the Schedule of Assets would improve the usefulness of this information and increase transparency into plan investments.[5]

David Cohen
Associate General Counsel, Retirement Policy

Notes

[1] US Government Accountability Office, RETIREMENT INVESTMENTS—Agencies Can Better Oversee Conflicts of Interest between Fiduciaries and Investors, GAO-24-104632 (2024), available at https://www.gao.gov/products/gao-24-104632 ("Report").

[2] For a summary of the 2016 fiduciary rulemaking (prior to its being vacated in 2018), see ICI Memorandum No. 29837, dated April 13, 2016, available at https://www.ici.org/memo29837.

[3] ICI Research is reviewing the GAO analysis, data, and methods.

[4] Report, p.74.

[5] For a summary of these proposed revisions, see ICI Memorandum 33783, dated Sept. 22, 2021, available at https://www.ici.org/memo33783.

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.