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Office of Regulations and Interpretations, Employee Benefits Security Administration
Room N–5655, U.S. Department of Labor
200 Constitution Ave. NW, Washington, D.C. 20210

Submitted Electronically via Federal eRulemaking Portal: http://www.regulations.gov.

Re: Attention: Definition of Fiduciary—RIN 1210–AC02

To Whom It May Concern:

Morningstar, Inc. appreciates the opportunity to comment on "Retirement Security Rule: Definition of an Investment Advice Fiduciary" and the related Prohibited Transaction Exemptions. We support the rule, and we believe that: 1) the rule would result in retirement investors receiving higher-quality advice, and 2) higher-quality advice could save retirement investors hundreds of billions of dollars over the next 20 years.

In this comment letter, we lay out supporting analysis to quantify the potential benefits of this rule in two areas: 1) the reduction in fees that retirement investors would pay when they save through workplace retirement plans, and 2) the reduction in implicit fees investors would pay when rolling over to fixed index annuities. We believe that there will be benefits to retirement investors in other areas, but these two are the most important on which to focus. We also offer some observations about the practicalities of complying with the rule in the absence of better plan data, and the need for additional guidance while enhancements to the Form 5500 are finalized. Finally, we conclude with a few recommendations based on our empirical analysis to improve the rule while protecting investors.

Executive Summary

We find that the proposed rule would have significant benefits for retirement investors. Specifically, we find that for retirement investors participating in a workplace retirement plan:

- Average costs for workers covered by a small plan would drop from 93 basis points down to 75 basis points, while there would be minimal changes for most other plans.
- Participants would save over $55 billion in the first 10 years and over $130 billion in the subsequent 10 years, in undiscounted and nominal dollars.
- Over 80% of these savings would be experienced by small-plan participants, of which there are currently more than 20 million.

For retirement investors rolling money into fixed index annuities, we find:

- Retirement investors rolling into annuities would save over $32.5 billion in the first 10 years and over $32.5 billion in the subsequent 10 years, in undiscounted and nominal dollars.[1]
- We did not quantify other likely benefits, such as a reduction in surrender fees paid by investors.

Although this proposed rulemaking does not address data quality issues, until the Department of Labor completes a comprehensive Form 5500 reform, there will be substantial gaps in data, somewhat limiting the benefits of the rule. Fiduciary advisors will not be able to easily establish a benchmark for plan fees, nor, in many cases, will they be able to access reliable information about a plan's investment options when analyzing the advisability of a rollover.

To improve the rule, we make the following recommendations:

1) The Department should include an assets-based test for an independent fiduciary with financial expertise for plan sponsors with more than $100 million in assets.
2) The Department should require lifetime income recommendations to consider participants' Social Security benefits as part of their best-interest analysis.
3) The Department should immediately revisit its previous Form 5500 reform proposals to ensure the Fiduciary Rule and related Prohibited Transaction Exemptions meet its goals.

We Estimate Retirement Investors Would Save $55 Billion in Fees Over the Next 10 Years as Workplace Retirement Plans Seek Cheaper Investments in Response to the Rule

Investors in smaller retirement plans pay considerably more than their luckier counterparts at larger companies with larger plans. In fact, as we reported in the "2023 Retirement Plan Landscape Report," participants in small plans—those with less than 25 million in assets—pay nearly twice as much as participants in large plans, based on the median reported fees as a percent of assets under management in publicly available disclosures.[2] Of course, some of that gap is because on an AUM basis, smaller plans with lower levels of investable assets pay more as a percentage of their assets for administrative and recordkeeping services. Nonetheless, smaller plans also have a much higher range of fees, as shown in Exhibit 1, which suggests many plans pay unreasonably high fees.

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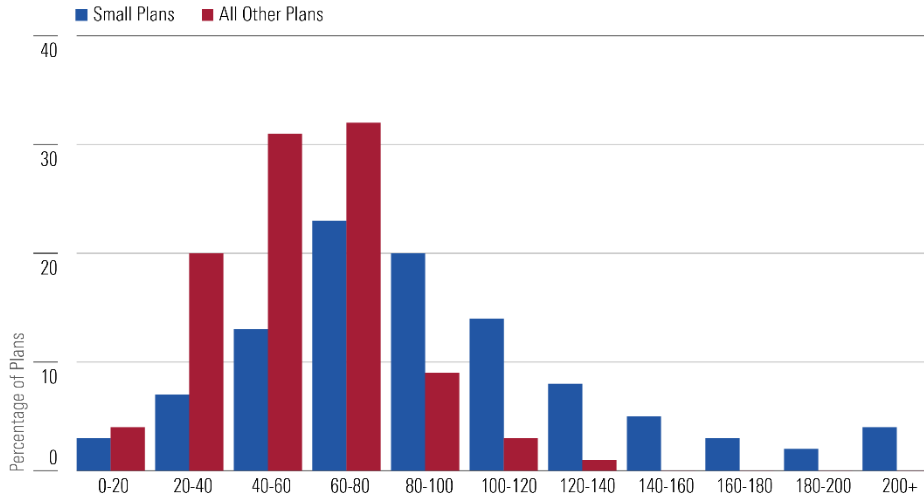
[1] These numbers are based on an industry representative pricing spread of 2.00%. If the industry representative pricing spread is 1.75%, we note that investors would save $21.6 billion in each 10-year period, in undiscounted and nominal dollars. Refer to the text of the letter for description of the methodology.

[2] Mitchell, L. 2023. "2023 Retirement Plan Landscape Report." https://www.morningstar.com/lp/retirement-plan-landscape-2023.

Exhibit 1 Total Costs Participants Pay (in Basis Points) to Invest in Defined-Contribution Plans—Small Plans and all Other Plans



Source: Morningstar 2023 Retirement Plan Landscape Report.

Some of these investment fees look outlandish compared with the investment universe, and we believe that the proposed rule and PTEs would result in plan fiduciaries examining their investment lineups and the fees their plans pay. Firms that aid plan sponsors in the construction of their plan lineups—and that would newly be considered fiduciaries under the proposed rule—will need to comply with the amended PTEs to receive compensation that would otherwise be prohibited. In doing so, they will need to ensure their recommendations are prudent and their fees are reasonable. Plans that currently have significantly above-average costs are unlikely to meet these standards, resulting in the firms providing them advice to recommend changes. For example, the fees investors pay purely for investment management are much, much lower than what is commonly found in small plans. Across all mutual funds and exchange-traded funds, the asset-weighted average net expense ratio investors pay is just 0.37%.[3] When the scope is narrowed to just "unbundled" share classes that Morningstar tracks—which are mutual funds and ETFs in which the expense ratio does not include additional charges for administrative expenses that are paid to a third party for services—the fees are even lower, as shown in Exhibit 2. We show the amounts for target-date funds, which are commonly used by retirement investors, and all other funds.

[3] Armour, B. & Evens, Z. 2023. "2022 U.S. Fund Fee Study." https://www.morningstar.com/lp/annual-us-fund-fee-study.

Exhibit 2: Average and Median Expenses for Unbundled Mutual Funds in 2023 (in Basis Points)

	Asset-Weighted Average Expense Ratio	Median Expense Ratio
Target Date	1	32
Other Funds	14	59
All Funds	14	54

Source: Morningstar data.

Table notes: We use the prospectus net expense ratio for these calculations as of Nov. 14, 2023.

Of course, plans must pay for administrative expenses such as recordkeeping, and we do not expect them to deliver all-in costs that only reflect the costs of investment management to the extent that participants pay administrative expenses on an AUM basis. But, given the costs of investment management, we do not believe that even with administrative expenses, any U.S. plan or its fiduciary would feel comfortable maintaining a plan with more than 100 basis points in fees to participants, given how common it is to pay much less. We are not endorsing 100 basis points as a definitive threshold in this letter, but we believe it is a conservative, reasonable assumption for a level at which plan sponsors and their advisors would review their plan in almost all cases if the proposed rule were finalized.

Small plans are much more likely to have unusually high fees in excess of 100 basis points compared with plans of other sizes, and we believe these are the fees that would be corrected if the proposed rule and related PTEs were finalized. As shown in Exhibit 3, we find unusually high fees are almost exclusively paid by participants in smaller plans.

Exhibit 3: Percent of Plans With Unusually High All-In Fees by Plan Size

Plan Size (by Assets)	**Percentage of Plans With Fees Higher Than 100 Basis Points**
Less than $25 million	35%
$100 million or less in assets, but more than $25 million	5
$500 million or less in assets, but more than $100 million	2
More than $500 million in assets	<1

Source: Morningstar analysis of Form 5500 data.

We estimate the rule would result in at least an 18-basis-point drop in the fees paid by participants in small plans, leading to billions of dollars of savings for workers who are preparing for retirement. As a conservative approach to estimating the benefits of the final rule, we assume that plans with all-in costs in excess of 100 basis points would reevaluate their fees and be able to adjust their plan to impose costs on participants at the current average for their respective plan size. The current and new expected average fees paid by participants in plans are shown in Exhibit 4.

Exhibit 4: Current and Projected (Under the Proposed Rule) Average Expenses for Plans by Size (in Basis Points)

Plan Size (by Assets)	Current Average Total Fees	Projected Average Total Fees
Less than $25 million	93	75
$100 million or less in assets, but more than $25 million	61	58
$500 million or less in assets, but more than $100 million	48	47
More than $500 million in assets	42	42

Source: Morningstar analysis of Form 5500 data and the methodology described in this letter.

Even if most plans do nothing, but outlier plans make modest adjustments to their investment lineups, participants will save more than $55 billion in fees in the next 10 years and more than $130 billion over the subsequent 10 years. We find that these significant benefits are mostly for workers who participate, or have participated in and still have assets in, smaller retirement plans. Exhibit 5 shows the total savings, assets, and current participants we use in our analysis.

Exhibit 5: Current and Projected (Under the Proposed Rule) Average Expenses for Plans by Size (in Basis Points)

Plan Size (by Assets)	2020 Assets (in Billions and Nominal Terms)	2020 Participants (in Millions)	Annual Projected Growth of Plan Assets	10-Year Savings (in Billions)	20-Year Savings (in Billions)
Less than $25 million	$1,714.4	22	4.92%	$47.3	$154.4
$100 million or less in assets, but more than $25 million	926.7	10	7.46	5.0	20.8
$500 million or less in assets, but more than $100 million	1,421.5	14	7.09	2.6	10.5
More than $500 million in assets	5,817.4	38	12.13	0.0	0.0
Grand total	**$9,879.9**	**N/A**	**9.29**	**$55.0**	**$185.6**

Source: Morningstar analysis of Form 5500 data and the methodology described in this letter.

Table notes: We start with the total assets reported in 2020 defined-contribution plans and inflation-adjust the assets to nominal dollars before applying any calculations. We project assets forward with current and projected revised fees based on the asset growth by plans of the previous 10 years, much of which is from contributions and new plan formation, less plan terminations. The difference between current projected growth and projected growth with lower fees anticipated in response to the rule is the projected savings, which are undiscounted and unadjusted for inflation. Please note that participant numbers cannot be added because participants could participate in multiple plans.

We Estimate That Investors Rolling Retirement Funds Into Fixed Index Annuities Would Keep Around $32.5 Billion More of Their Retirement Savings Due to the Rule Over the Next 10 Years

The Department identifies rollovers to fixed index annuities as an area in which the rule might produce significant benefits to ordinary investors because these products are not securities and are thus not covered by Regulation Best Interest. Morningstar found that the rule would likely lead to significant savings for retirement investors rolling into fixed index annuities. Morningstar believes the proposed rule would save retirement investors approximately $3.25 billion per year, with a low-end estimate of $1.77 billion per year and a high-end estimate of $3.84 billion per year. These results are undiscounted, and we do not have a basis to assume that fixed index annuity sales volume would change over time. The range of estimates for the savings to retirement investors is shown in Exhibit 6.

Exhibit 6: Increase in Savings for Retirement Investors Rolling Into a Fixed Index Annuity Assuming Industry Representative Pricing Spread Reduces to 1.25% Due to the Proposed Rule

Scenario	**Years**	**Undiscounted Savings in U.S. Dollars Assuming Fixed Index Annuity Holding Period of 7 Years (in Billions)**		
		45% of Premium Impacted	**55% of Premium Impacted**	**65% of Premium Impacted**
Current Industry Representative Pricing Spread of 1.75%	1-Year	$1.77	$2.16	$2.55
	10-Year	17.67	21.60	25.52
	20-Year	35.34	43.19	51.05
Current Industry Representative Pricing Spread of 2.00%	1-Year	2.66	3.25	3.84
	10-Year	26.57	32.48	38.38
	20-Year	53.14	64.95	76.76

Table notes: Please see text of letter for an explanation of the methodology. For both scenarios we assume a $99.75 billion annual premium volume.

Our estimate does not attempt to quantify the benefits of guaranteed lifetime withdrawal benefits, as we assume those fees are reasonable for the value they deliver. Rather, to generate these estimates, we quantified the impact by estimating the increase in the account balance of a generic fixed index annuity over a seven-year holding period assuming lower implicit cost assumptions than are currently seen in the industry, which represent scenarios wherein fixed index annuity commissions decrease due to insurance producers following the impartial conduct standards. To measure the change in account balance, we varied the underlying pricing spread. A pricing spread refers to the yield that the insurance company takes from the earned

rate of the supporting general account portfolio for overhead costs and profit. We multiplied the estimate of the change in account balance by an estimate of total fixed index annuity sales in 2023 and by an estimate of the percentage of affected premium.

In terms of scope, we only addressed potential benefits for a single product, and there are likely additional benefits to retirement investors. We did not conduct an impact analysis with respect to other fixed annuities because these products tend to have lower commissions than fixed index annuities. We also did not analyze variable annuities or registered index-linked annuities because these annuities are registered as securities, and thus, the impact of the proposal would not be nearly as significant, as the Department noted in the preamble.

We also did not try to ascertain whether a guaranteed lifetime stream of income is or is not in the best interests of the participants who purchase these annuities, but we believe there could be important benefits for retirement investors if fiduciaries provide best-interest advice on lifetime income. For example, Morningstar has concluded that for most retirees seeking guaranteed income, delaying the claiming of their Social Security benefit is likely the best way to start to lock in guaranteed retirement income.[4] Social Security benefits are adjusted for inflation, and in plausible interest-rate environments, the increases a participant could get from delaying are worth considerably more than what they could get from a private underwriter.

Finally, we believe another benefit would likely be a reduction in investors paying surrender charges, but we did not attempt to quantify this benefit to investors. Nonetheless, the proposed rule would likely result in lower surrender fees paid by consumers because the products they buy should better fit with their circumstances and preferences given that the recommendations to purchase them should be in their best interests. More details of the methodology are in the technical appendix, but the most important parameters for the estimate follow:

- We used a seven-year holding period for this analysis because fixed index annuities with a seven-year surrender period represent the middle ground between shorter-term fixed index annuities with three- or five-year surrender periods and products with longer-term surrender periods of 10 or more years.
- The industry representative pricing spreads are based on two Milliman actuarial white papers and Morningstar analysis of real fixed index annuity rate quotes. Morningstar used a 1.25% pricing spread to represent the impact of the proposal because it is more consistent with the spreads on fixed-rate annuities (also referred to as multiyear guarantee annuities). Refer to the appendix for more detail on these assumptions.
- The annual premium volume used in the calculation is based on an estimate of total fixed index annuity sales in 2023. The estimate was calculated by multiplying total 2022 fixed index annuity sales as reported by LIMRA by a factor of 1.25%.[5] The factor

[4] Look, S. & Szapiro, A. 2022. "The Retirement Plan Lifetime Income Strategies Assessment." https://www.morningstar.com/lp/lifetime-income-strategies-assessment.

[5] LIMRA. 2023. "Preliminary U.S. Individual Annuity Sales Survey, Third Quarter 2023." https://www.limra.com/siteassets/newsroom/fact-tank/sales-data/2023/q3/prelim-3q-2023-annuity-sales-estimates-v-updated.pdf.

is the LIMRA estimate of the ratio of total fixed index annuity sales through the third quarter of 2023 to total fixed index annuity sales through the third quarter of 2022.

- The percent of fixed index annuity sales that would be affected by the proposal represents the share of sales involving qualified assets. The baseline estimate for the percent of qualified sales was 55%, which is based on 2021 sales numbers from the Insured Retirement Institute[6] and sales trend analysis from the Society of Actuaries.[7] We also included analysis when the percent of qualified sales was 45% and 65%, to show a potential range of outcomes.

The Benefits of the Proposed Rule Will Be Blunted by a Lack of Data Until the Department Completes its Form 5500 Reform Rulemaking

As the Department acknowledges, fiduciaries recommending a rollover out of a qualified plan often do not have the information they need unless a participant brings them a 404(a)5 disclosure. Without revisions to the Form 5500—of the type proposed in 2016 and 2021—it will continue to be challenging for fiduciaries providing advice presale to plans or for individuals to understand the investments that retirement plans hold and the compensation they pay to their providers.

We have previously commented on the most efficient, cost-effective ways to reduce the large gaps in the Form 5500 disclosures for the purposes of improving the quality of analysis required under PTE 2020-02. These gaps include: many plans for which there is no share class information on their investment lineup, leading to a wide variation in possible fees a participant may pay; limited information on pooled investments that are not registered open-end mutual funds, denying fiduciaries up-to-date and accurate cost information for many investment strategies and structures; and a lack of information on the costs of many services, such as technology fees for managed accounts or other automated advice.

This lack of information means it is also impossible to benchmark fees for other services provided to retirement plans without an updated Form 5500. For example, CITs often cost less than registered open-end mutual funds, but it is unclear how much less they cost because of disclosure issues. The rule will also potentially add new scrutiny on technology fees or other fees paid to intermediaries who make recommendations to plans for services such as managed accounts, which might result in them collecting this fee. While we applaud this scrutiny, in the absence of better disclosures, it will not be possible to ascertain to what extent a fee is reasonable compared with similar services provided by other providers until the Department completes a comprehensive Form 5500 review. We believe that fiduciaries should still be able to demonstrate that a service adds more value than it costs, despite the challenges with disclosures.

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[6] IRI. 2022. "Annuities Post Highest Sales Since 2008." https://www.irionline.org/news/article/iri-issues-year-end-2021-annuity-sales-report/.

[7] Baiye, S. 2016. "Individual Annuity Sales and Product Trends." *Society of Actuaries*. https://www.soa.org/globalassets/assets/library/newsletters/product-development-news/2016/february/pro-iss-103-baiye.pdf.

Recommendations to Improve the Rule

We recommend the following adjustments based on our empirical analysis of the rule:

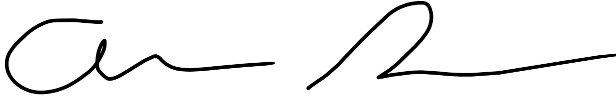
1) **The Department should include an assets-based test for an independent fiduciary with financial expertise for plan sponsors with more than $100 million in assets**. The Department notes that it is "unaware of compelling evidence that wealth and income are strong proxies for financial sophistication" in the preamble to the proposed rule. We believe we have such evidence. In our analysis, we see little to no benefit of imposing the same conditions on giving advice to individuals regarding plans with more than $100 million in assets—a threshold at which we project minimal benefits to plans and their participants from the rule**.**

2) **The Department should require lifetime income recommendations to consider participants' Social Security benefits as part of their best-interest analysis**. The Department appropriately maintains the requirement in PTE 2020-02 to consider a retirement investor's plan costs and features before recommending a rollover out of a plan. In the case of a recommendation to purchase an annuity with lifetime income protection, we believe it is only logical that a fiduciary acting in a participant's best interests would also consider any pension income they are owed in addition to their defined-contribution plans' costs and features. Additionally, since most workers accrue Social Security benefits, prudent fiduciaries should be required to consider a participant's likely benefit based on their wage record and whether an annuity would still be in a participant's best interest.

3) **The Department should immediately revisit its previous Form 5500 reform proposals to ensure the Fiduciary Rule and related Prohibited Transaction Exemptions meet their goals.** There are significant data gaps that will impede fiduciaries from acting in retirement investors' best interests until plan disclosures are improved.

Thank you for the opportunity to comment on the “Retirement Security Rule: Definition of an Investment Advice Fiduciary” and the related Prohibited Transaction Exemptions.

Sincerely,



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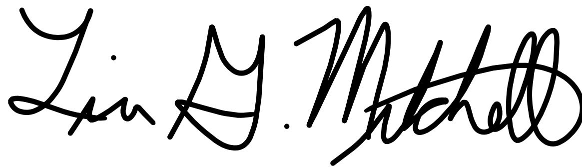

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Technical Appendix—Fixed Index Annuity Analysis

Morningstar carried out the impact analysis by forecasting the account balance of a generic fixed index annuity using a standard actuarial approach and varying the underlying pricing spread assumption. A pricing spread refers to the yield that the insurance company takes from the earned rate of the supporting general account portfolio for overhead costs and profit. Morningstar performed the following steps.

1. Forecast the ending account balance in a fixed index annuity across 1,000 economic scenarios for a seven-year holding period, assuming a pricing spread of 1.75% and a pricing spread of 2.00%. These two runs represent the baseline scenarios in the analysis.
2. Repeat the above step with a pricing spread of 1.25%. This represents a scenario in which lower commissions may lead to a lower pricing spread.
3. For each of the pricing spread scenarios, calculate the mean account balance at the end of the seven-year period.
4. Calculate the percentage change in the mean account balance between the baseline cases and the scenario with the lower pricing spread.

Regarding the fixed index annuity assumptions, Morningstar used an S&P 500 cap strategy to calculate the credited interest rate in each year and simulated path. The baseline pricing spread assumptions that are used are in line with two Milliman actuarial fixed index annuity white papers that use a 2.00% pricing spread[8] and a 1.50% pricing spread.[9] Morningstar noted that the 2.00% pricing spread was more consistent with Morningstar's analysis of implied pricing spreads based on yield-curve data and real fixed index annuity rate quotes.[10]

Morningstar conducted similar analysis of implied pricing spreads for fixed-rate annuities. Morningstar noted that the implied pricing spreads were significantly lower, oftentimes near 1.00%, and in some cases, closer to 0.75%.

Morningstar forecast the caps and equity index price returns when calculating what is credited to the policyholder's FIA contract value. To forecast the caps, Morningstar used an option-budget approach, which is commonly used in actuarial valuation and projection for index

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[8] Chang, G. C., Feng, L. F., Matczak, B. M., & Yadatore, K. Y. January 2020. "Fixed indexed annuities with Market Risk Benefits." *Milliman*. Retrieved Nov. 29, 2022, from https://us.milliman.com/-/media/milliman/pdfs/articles/fixed_indexed_annuities_with_market_risk_benefits.ashx.

[9] Dattani, A., Low, Z. X., Motiwalla, Z., Wang, K., & Yadatore, K. October 2020. "Principle-based reserving impact on fixed indexed annuity pricing." *Milliman*. Retrieved Jan. 9, 2023, from https://us.milliman.com/-/media/milliman/pdfs/2020-articles/articles/10-14-20-pbr-for-non-var-annuities-v1.ashx.

[10] Morningstar compared the fixed rates offered by various FIA contracts (through Morningstar's Annuity Intelligence Center) to Baa Corporate bond benchmarks. The difference between the benchmark yield and the fixed rate is a rough estimate of the pricing spread.

products.[11] Morningstar modeled the option budget as the projected book yield of the supporting general account portfolio less a pricing spread. The general account portfolio yields are projected assuming that a percentage of the portfolio turns over and is reinvested at the new money rate. The portfolio yield at the start of the projection is assumed to be 5.5%.[12] New money rates are projected as the 10-year Treasury plus a 1.5% asset spread. The asset spread assumption is intended to be a conservative estimate and is generally in line with the long-term benchmark spread, after reflecting default costs, for principle-based reserving Baa1/BBB+ rated assets as of December 2022.[13] Morningstar assumes that the turnover period for the portfolio is 10 years, meaning that one tenth of the portfolio is reinvested each year.
The forecast portfolio yield is then calculated as the weighted average of the yields from each bucket of the portfolio. Next, Morningstar subtracts a pricing spread from the forecast portfolio yield to arrive at the option budget. Morningstar varies the pricing spread in the analysis.

Using the forecast option budgets, Morningstar solves for the index-strategy rates such that the market costs of implementing the credited-rate strategy is equal to the option budget. For the point-to-point cap method, this entails entering into a bull call spread, or buying an at-the-money call and selling an out-of-the money call. The strike price for the out-of-the-money call is what is solved for, and it represents the cap rate.

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[11] Refer to Chang et al. (2020).

[12] This estimate is based on the Moody's Seasoned BAA Corporate Bond Yield in late 2022 and early 2023. Refer to "FRED Economic Data." (Feb. 1, 2023). https://fred.stlouisfed.org/series/BAA.

[13] PBR Data. (n.d.). https://content.naic.org/pbr_data.htm#collapse-accordion-2171-1.