GAO Highlights

Highlights of GAO-24-104632, a report to congressional requesters

July 2024

RETIREMENT INVESTMENTS

Agencies Can Better Oversee Conflicts of Interest between Fiduciaries and Investors

Why GAO Did This Study

The interests of financial professionals and firms often conflict with the interests of retirement investors. This could create risks for millions of investors with over $18 trillion dollars in retirement savings in 401(k) plans and IRAs. Although federal agencies have taken steps to mitigate such conflicts, GAO was asked to assess where issues around conflicts of interest and investment advice stand today.

This report examines (1) industry changes to address the 2016 rule; (2) conflicts that can affect retirement investors, how they are communicated, and their association with investment returns; and (3) federal oversight of conflicts and actions that could improve oversight.

GAO interviewed financial industry associations to identify industry changes, examined disclosures from over 15,000 firms and conducted undercover calls to 75 financial professionals to identify conflicts and determine how they are communicated. GAO also performed a regression analysis to assess the association between conflicts and investment returns; and reviewed relevant federal laws and regulations and interviewed agency officials and others.

What GAO Recommends

GAO is making two recommendations to IRS, including that it develop and implement a proactive process to identify prohibited transactions between IRA fiduciaries and IRAs, and assess any associated excise tax. IRS agreed with our recommendations.

View GAO-24-104632. For more information, contact Tranchau (Kris) Nguyen at (202) 512-7215 or nguyentt@gao.gov.

What GAO Found

Financial professionals providing retirement investors fiduciary investment advice must generally avoid conflicts of interest. Conflicts of interest can arise from, among other things, proprietary products, payments from third parties, and compensation arrangements, among other things. The Department of Labor (DOL) issued a final rule in 2016 that expanded the definition of fiduciary investment advice. That rule was vacated in 2018.

Firm responses to DOL's rule change varied. To comply, some firms moved toward standardized compensation for financial professionals, and away from compensation that can depend on recommendations, according to several industry association representatives. After the rule was vacated, some firms reversed certain practices established under the rule, and other firms kept their new practices.

Conflicts of interest disclosures are not always clear or understood. GAO found many conflicts associated with recommending one product over another in a review of over two thousand descriptions of conflicts of interest in required disclosures. Firms' disclosures of conflicts are available to investors, although—based on GAO's review of disclosures and prior GAO work—investors may not review or understand these documents. Federal agencies encourage investors to ask professionals about conflicts of interest, but GAO's undercover calls found that doing so may not always produce helpful information.

Mutual funds that compensate financial professionals are associated with lower average returns. GAO's analysis of Morningstar mutual fund data from 2018 to 2021 found that funds that compensate financial professionals based on whether their clients invest in those funds (a proxy for conflicts) is associated with lower average returns before fees. This could reduce retirement savings' growth over time and could make a difference of tens of thousands of dollars for investors in actively managed domestic equity funds at retirement.

IRA fiduciary oversight lacking. By law, the Internal Revenue Service (IRS) has sole enforcement authority over firms and financial professionals acting as fiduciaries under the Internal Revenue Code for Individual Retirement Accounts (IRA fiduciaries). IRS's approach to protect IRA investors from the conflicts of interest of IRA fiduciaries who engage in prohibited transactions relies on the IRA fiduciary self-reporting to IRS and paying the applicable excise tax, according to IRS officials. According to IRS, the excise tax is intended to safeguard income for retired workers by taxing transactions deemed particularly objectionable because of the potential for abuse of fiduciary responsibilities by parties having conflicts of interests. IRS officials said their practice regarding IRA fiduciaries is to enforce prohibited transactions that DOL refers to them. However, DOL does not have authority to audit IRAs for prohibited transactions and, therefore, is generally unable to refer IRA fiduciaries to IRS for excise tax enforcement. Until IRS implements an audit process for IRA fiduciaries, IRA investors may continue to be exposed to adverse impacts of prohibited transactions that can jeopardize their financial security in retirement.