

July 21, 2015

Office of Regulations and Interpretations
Employee Benefits Security Administration
Attn: Conflict of Interest Rule
Room N-5655
U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20210

RE: RIN 1210-AB32 – Conflict of Interest Rule

Dear Sir or Madam:

On behalf of a group of firm clients, I am writing today to provide comments on the Department of Labor’s (“DOL”) proposed new definition of a fiduciary, the proposed new prohibited transaction exemptions, and the proposed modifications of existing exemptions (together referred to as the “proposal”). Overall, while we share the belief that firms should act in their clients’ best interest, the implementation of the DOL’s regime renders the proposal unworkable.

This letter is divided into eight main sections. The first section describes concerns with the proposal and the adverse effects that the proposal would have. Second, in response to DOL’s request for specific alternatives, the letter provides a regulatory approach that would address DOL’s objectives, but without the adverse effects of the proposal. The third section discusses why DOL does not have the statutory authority to issue very significant portions of the proposal. Fourth, the letter examines the shortcomings of DOL’s economic analysis. Fifth, the Appendix to this letter provides regulatory language for one aspect of our recommended regulatory approach. Sixth and seventh, attached to this letter are in-depth studies by Quantria Strategies, LLC of (1) the shortcomings of DOL’s economic analysis and (2) the adverse effects of the proposal on retirement savings and retirement readiness. Finally, also attached is a response from Quantria regarding a discussion in DOL’s regulatory analysis of a prior study performed by Quantria, as explained further below.

We are also attaching for the record key studies cited in this letter: “Oliver Wyman report: Assessment of the impact of the Department of Labor’s proposed “fiduciary” definition rule on IRA consumers” (April 12, 2011); “Access to Call Centers and Broker Dealers and their Effects on Retirement Savings”, Quantria Strategies, LLC (April 9, 2014); “The Impact of the Upcoming Re-Proposed Department of Labor Fiduciary Regulation on Small Business Retirement Plan Coverage and Benefits”, Greenwald & Associates (May 14, 2014); and “The role of financial advisors in the US retirement market”, Oliver Wyman (July 10, 2015).

SUMMARY

Summary of Section 1 of the letter: concerns with the proposal.

- **Industry supports best interest standard.** Contrary to indications from the Administration and statements in the press, most of the financial services industry is

completely fine with a best interest standard developed and implemented by the appropriate regulatory authorities. Indeed, the industry has been fine with this since the original DOL proposal was issued in the fall of 2010. The problem with the DOL proposal is not the premise that firms should act clients' best interest; the problem is the "prohibited transaction rules" that would cut off low and middle-income individuals and small businesses from access to personal investment assistance. Unfortunately, the proposal does not address this fundamental problem, as explained in this letter.

- The Administration's own analogy to doctors working in their patients' best interest illustrates the flaws in the proposal, since no doctor could work under a regime like the rules proposed by the DOL.
- The Administration's references to hidden fees are not consistent with the fact that DOL prohibited hidden fees with respect to plans in 2012.
- **Small businesses will lose critically needed help in setting up retirement plans.** Any meaningful assistance for small businesses in selecting or monitoring investment options would give rise to fiduciary status and thus prohibited transactions. Since the best interest contract exemption (the "BICE") does not apply to participant-directed small business plans, and the overwhelming majority of small business plans are participant-directed, there is effectively no prohibited transaction relief for advice to small businesses. The result would be cutting small businesses off from meaningful assistance in setting up and maintaining a plan.
- **Small IRA accounts will lose almost all access to professional investment advice.** Small IRA accounts generally do not have access to advisory assistance from registered investment advisers. The primary access to personal investment assistance for small IRA accounts is through the brokerage model, but the brokerage model gives rise to prohibited transactions unless the BICE can be used. Briefly, I am not aware of any financial institution that is planning to use the BICE or could possibly use the BICE; it is unusable. Even if it were usable, it would take years to program, so no one could possibly use it by the applicability date. This means that under the proposal small IRA accounts would lose almost all access to personal investment assistance. It is well documented that this occurred in the United Kingdom under a very similar rule.
- **Under the current timetable, the following message will be delivered to many millions of individual IRA investors with small accounts in the fall of 2016: neither their current adviser nor any other similar adviser can service their accounts because of new government rules.**
- **The DOL proposal would eliminate any meaningful assistance for employees terminating employment regarding their distribution and rollover options.** According to a comprehensive study by former government economists, this would result in \$20 billion to \$32 billion more in annual leakage from retirement plans.
- **The DOL proposal significantly reduces the scope of permissible investment education.** Even the 2010 DOL proposal did not do this.
- **The DOL proposal would treat individualized promotion of a company's own products and services to small businesses and individuals as fiduciary advice, and thus generally prohibited.** Even the 2010 proposal did not go nearly this far.
- **The DOL proposal inadvertently applies to the simple marketing of health, life, and disability insurance to small businesses, making such marketing arguably**

impermissible. This inadvertent error is more evidence that the adverse ramifications of the proposal have not been fully considered.

- **The 2015 proposal is far less workable than the 2010 proposal, as it has many new onerous aspects.**
- **All of this can be solved by regulations establishing a best interest standard, with workable rules that maintain access to investment assistance for low and middle-income individuals and small businesses.**

Summary of Section 2 of the letter: our recommended regulatory approach.

The proposed rule should be withdrawn in deference to the primary role of the SEC and FINRA in establishing standards for broker/dealers and financial advisers. If, however, the DOL resolves to adopt a final rule, our recommended regulatory approach would include the following key elements:

- A broadly applicable best interest standard, under which advice provided by financial professionals regarding investments, distributions, and rollovers would be required to be in the best interest of their ERISA plan and IRA customers.
- A workable prohibited transaction exemption under which financial professionals would be permitted to provide investment, distribution, and rollover assistance as long as the assistance is in their customer's best interest and the financial professional's financial incentives are fully disclosed.
- A seller's exception based on the DOL's 2010 proposal under which financial professionals who make it clear that they are selling products or services and not undertaking to advise an investor would not be considered fiduciaries.
- Preservation of financial education. Unlike the 2010 DOL proposal, the 2015 DOL proposal would substantially restrict the types of investment education that can be provided without triggering potential fiduciary liability. Our approach preserves the current-law rules regarding investment education and, as under the DOL proposal, extends the education rules to education provided to plan sponsors and IRA owners, and to education regarding distributions and rollovers.

Summary of Section 3 of the letter: large portions of the DOL proposal are not within DOL's statutory authority.

Here is the statutory language in ERISA section 3(21) that DOL is interpreting in the proposal: "a person is a fiduciary with respect to a plan to the extent . . . (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so". The proposal goes far beyond this statutory language and is thus broadly invalid. For example:

- **Coverage of selling that is not advice.** Under the proposal, individualized promotion of products or services to an individual or small business is fiduciary advice, even if the seller makes it clear that he or she is selling, not advising, and that is understood by the recipient of the promotion. There is no way to reconcile this treatment with a statute that requires the rendering of "investment advice for a fee" to be a fiduciary, and with a

statutory framework that recognizes that sales often involve incidental advice that does not give rise to fiduciary status.

- **Coverage of casual statements not viewed as advice by either party.** Under the proposal, a mild statement that is reasonably viewed as a suggestion triggers fiduciary status, even if neither party views the statement as investment advice. Such a rule cannot be reconciled with a statute that requires the rendering of “investment advice” to trigger fiduciary status.
- **Coverage of distribution advice.** The DOL has no authority under the statute to treat advice regarding whether to take a distribution as “investment advice”. Assume, for example, that an adviser advises a participant to take a distribution of her plan account and roll into an IRA but the adviser expresses no opinion on whether the participant should roll over her plan holdings into the IRA or should liquidate the plan holdings and invest in different assets in the IRA. How could this possibly be treated as investment advice regarding plan assets? Moreover, as discussed below, the DOL’s current position is in direct conflict with their own interpretation of the exact same law, which was the correct interpretation.
- **Indirectly regulating IRAs.** Assume that DOL were to issue a regulation that directly imposes a series of regulatory requirements on IRAs, such as (1) disclosure rules, (2) a requirement that contracts be entered into with IRA owners, and (3) restrictions on the types of compensation that can be paid to IRA advisers. Legal analysts would agree that DOL has no such authority over IRAs and that the regulatory requirements would be invalid. Yet that is exactly what DOL has done here indirectly.

Summary of Section 4 of the letter: shortcomings of DOL’s economic analysis.

One theme is consistent throughout the DOL’s Regulatory Impact Analysis (“DRIA”), which is that it reads almost exactly like a brief prepared by an advocate who is retained to defend the DOL proposal in all events. Accordingly, in many cases discussed in detail in Section 4 of this letter, the DRIA (1) attempts to refute contrary positions with incorrect statements, and (2) omits points that undermine the proposal. In addition, there are many instances, such as the education restriction, where the DRIA does not even explore the possible adverse effects of the proposal or possible more flexible ways to achieve DOL’s stated objectives.

Here is one of many examples. A 2011 DOL analysis states that the prohibited transaction rules are “at least in part” responsible for over \$100 billion of losses per year. Yet the 2015 DOL proposal does not address this point in very significantly broadening the application of those prohibited transaction rules.

Section 5 is in the Appendix and Sections 6-8 are attached

SECTION 1: CONCERNS REGARDING THE PROPOSAL

INDUSTRY SUPPORT FOR A BEST INTEREST STANDARD

Under the DOL rules, an adviser’s treatment as a fiduciary has two main significances. First, a fiduciary is required to provide advice that is in the best interest of the fiduciary’s

customer, and second, a fiduciary becomes subject to an extensive set of prohibited transaction rules.

There has been a lot of confusion in public discussions and media reports that state that the industry opposes a best interest standard. That is not the case. Members of the financial services industry are completely fine with being required by the appropriate regulatory authorities to act in the best interest of their customers. Advisers know that if they do not act in their clients' best interest, they will not have those clients for long.

The public policy dialogue regarding the fiduciary issue over the last 4 ½ years has never been about the best interest standard. The real debate has been over DOL's authority and its "prohibited transaction rules," which under the DOL proposal would cut off access to investment and distribution assistance for low and middle-income individuals and small businesses. Under those rules, an adviser cannot provide any advice that could affect the adviser's compensation, in the absence of a prohibited transaction exemption (provided by DOL). Assume, for example, that an IRA owner calls a broker/dealer for advice regarding whether to buy a particular stock. The adviser responds by saying that the stock is regarded as a good value and could help the IRA owner's portfolio. The IRA owner buys the stock, which earns the broker/dealer a commission. Absent an exemption, if the broker/dealer is a fiduciary (as she would be under the DOL proposal), the simple favorable statement about the stock purchase is a prohibited transaction under the DOL proposal, regardless of whether the statement is in the best interest of the IRA owner. That is because the broker/dealer earns a commission on the purchase; thus, the broker/dealer's favorable statement led to the broker/dealer earning a commission.

The Administration's own doctor analogy illustrates the flaws in the proposal. The Administration has said that financial advisors should be held to the same best interest standard that patients expect from doctors. The industry is completely fine being subject to a best interest standard like doctors. But to picture the unworkability of the prohibited transaction rules, just imagine if those rules applied to doctors:

- A patient goes to a doctor with ankle pain. The doctor recommends an X-ray – which is done at the doctor's office -- to determine if the ankle is broken. Under the DOL rules, the doctor would have committed a prohibited transaction because the advice to get an X-ray leads to the doctor earning more money attributable to providing X-ray services for a fee. Under the prohibited transaction rules, the doctor would be required to send the patient to another doctor for an X-ray.
- ***A patient goes to a doctor with back pain. The doctor prescribes rest and anti-inflammatories, and recommends the patient come back in three weeks for a follow-up visit. The doctor would have committed a prohibited transaction by recommending a follow-up visit, which will earn the doctor more money. The doctor would be required to send the patient to another doctor for the follow-up visit.***

HIDDEN FEES ARE ALREADY BANNED

In 2012, the DOL issued rules making hidden fees illegal with respect to retirement plans; these rules were the product of work by both Democratic and Republican Administrations. Thus, we are not sure what the Administration is referring to when it makes consistent references to hidden fees in its discussions of the need for the 2015 DOL proposal. In addition, in the IRA market, Richard Ketchum, the CEO of FINRA (which oversees broker/dealers) noted in his May 27 speech at the 2015 FINRA Annual Conference that FINRA's robust disclosure rules "require that principal trades, commissions, fees and expenses must be disclosed to the customer and . . . require that revenue sharing arrangements with mutual funds generally must be disclosed if they form a basis for the selection of funds that the broker-dealer recommends." Ketchum also stated in the same speech that "depictions of the present environment as providing 'caveat emptor' freedom to broker-dealers to place investors in any investment that benefits the firm financially with no disclosure of their financial incentives or the risks of the product, are simply not true."

In light of the above, it would be helpful to understand better what hidden fees are being referenced by the Administration.

OVERALL STRUCTURE OF THE DOL PROPOSAL

The DOL proposal has three basic components:

- **Expansion of the basic definition of the term "fiduciary."** Under current law, a person is treated as a fiduciary if, for a fee, the person provides individualized advice regarding investments on a regular basis pursuant to a mutual understanding that the advice will be a primary basis for decision-making. In other words, there must be a mutual expectation of reliance on the advice.
 - Under the DOL proposal, a person is treated as a fiduciary if, for a fee, the person provides individualized or specifically directed recommendations regarding investments, rollovers, or distributions that could be considered in making decisions. Any recommendation that would be viewed as a "suggestion" that someone take an action – or not take an action – is sufficient. *So any casual comment that could be considered would give rise to fiduciary status.*
- **Exceptions from the definition of a fiduciary.** The proposal includes exceptions from fiduciary status, i.e., persons covered by the general definition above are not fiduciaries if they fall within certain exceptions, such as an exception for investment education (narrower than under current law or under the 2010 DOL proposal) and an exception for recommendations provided as a seller (not as an adviser) to large plans.
- **Exemptions from the prohibited transaction rules.** For persons that are treated as fiduciaries, the proposal provides limited exemptions from the prohibited transaction rules. The main exemption is the BICE. For reasons discussed below, the conditions required to satisfy the BICE are so extensive and onerous as to make it unusable. Effectively there is no exemption.

EFFECTS OF THE DOL PROPOSAL

The DOL proposal would have the following adverse effects.

In general. The framework set up by the DOL, *in its current form, would, like the original 2010 proposal, cut off the option for low and middle-income individuals and small businesses to receive personalized investment assistance, even if that assistance is in the best interest of the recipient.* This is the case because the BICE has so many unworkable requirements as to be unusable.

Small businesses could not get help setting up a retirement plan. When a financial institution talks to a small business owner about possibly setting up a 401(k) plan, the small business owner naturally wants to know if the plan can be established simply and inexpensively, with the financial institution taking care of almost everything. Today, that works well. The financial institution can, for example, provide the plan document, agree to do all the plan administration, and agree to help with employee communications.

One other key item is selecting the investment options for the plan to offer to employees. Typically, the financial institution has a large portfolio of possible investment options, such as, for example, 2,000, but the business likely may only want to offer, for example, 10 or 15 options to its employees. Accordingly, a critical step in setting up a plan is choosing the 10 or 15 out of the 2,000 that the plan will offer. Today, the financial institution can provide “education” to the business owner about which 10 to 15 to choose, without the financial institution becoming a fiduciary. For example, the financial institution could provide examples of investment options offered to employees by similar businesses, including sets of options that are conservative, moderate, and aggressive. The financial institution can explain the differences between the different sets of options and provide additional information that the owner needs to make an appropriate decision for the plan. (The financial institution will be clear that it cannot make the decision for the business owner and cannot act as a fiduciary, but can provide information and education.)

Under the DOL proposal, the assistance described above regarding the selection of the 10 or 15 investment options would be treated as investment advice and thus would make the financial institution a fiduciary. This would make the assistance a “prohibited transaction,” subject to severe penalties. Fiduciary advice is a prohibited transaction if the advice affects how much compensation the fiduciary earns. In almost all cases, the financial institution will make different amounts of money based on which investment options are chosen by the business owner. Some options may be proprietary funds and some may not be. Generally, the non-proprietary funds will pay the financial institution a fee, but the fee varies from fund to fund. Proprietary funds also vary in the management fee charged because certain investment strategies are more expensive to manage than others.¹ So in short, even if the financial institution recommends the best possible funds for the business owner to offer to his company’s employees, the advice is a prohibited transaction because the advice affects how much the financial institution earns.

So if the financial institution cannot help the business owner select the 10 or 15 investment options, the owner has two choices:

¹ These fees are not hidden. The fees earned both for proprietary and non-proprietary funds **are fully disclosed before the business owner adopts the plan** under DOL’s fee disclosure rules.

- Select the investment options himself, without any assistance, subject to fiduciary liability. If the owner is not an expert on investments, this would subject the owner to liability, since ERISA holds fiduciaries to an expert standard. A fiduciary *must* seek help and guidance if the fiduciary is not an expert.
- Conduct a diligent search, subject to fiduciary liability, for a qualified independent third party to do the selection *for an additional fee*.

Neither of the above choices is really viable in most cases, so there would be far fewer small business plans established. The adverse effects of the original proposal would continue to apply, since the 2015 proposal is, with respect to the small business issue, effectively identical to the original proposal. The adverse effects of the original proposal were powerfully demonstrated by the results of a 2014 survey of small businesses by Greenwald & Associates (which our firm co-sponsored, along with the U.S. Hispanic Chamber of Commerce). For example, the survey found that:

- Almost 30% of small businesses with a plan indicated that it is at least somewhat likely that they would drop their plan if this regulation were to go into effect.
- Close to 50% of small businesses without a plan stated that the regulation would reduce the likelihood of them offering a plan, with 36% saying it would reduce the likelihood greatly.

Small accounts will lose all access to an investment professional. There are two main ways that an IRA owner can get access to an investment professional: the brokerage model and the advisory model. Under the brokerage model, the amount of the payments to the adviser – such as commissions and payments from a mutual fund (e.g., marketing, recordkeeping, and shareholder servicing fees) – varies based on the investment made. Thus, under the proposal, any advice provided under the brokerage model to IRAs or retirement plans would violate the prohibited transaction rules unless an exemption applies. Because the BICE is unusable, the current brokerage model is effectively illegal with respect to IRAs and retirement plans under the DOL proposal. The only brokerage model that would be viable for IRAs and retirement plans would be a pure order-taker model with no advice provided.

As a practical matter, this would mean that the only source of personal investment assistance for an IRA owner would be through an investment advisory account. However, investment advisory services generally are not available to small accounts. Under an advisory account, typically, the registered investment adviser takes full responsibility for managing the investments on an around the clock basis in exchange for a fee based on the amount of assets, such as a 1% of assets fee. Small accounts generally are not eligible for advisory services in part because the economics do not work. An adviser typically cannot accept around the clock liability for a \$4,000 IRA for an annual fee of \$40.

Moreover, under the securities laws, an advisory service may not be suitable for a small account (or even a large account) if the IRA owner simply buys and holds securities. In fact, the SEC has made “reverse churning” and investment adviser account suitability – i.e., the

placement of buy and hold investors in an advisory account -- a priority for 2015 and has recently announced exams on this issue. ***Thus, the proposal is pushing investors toward advisory services while the SEC is putting up red flags with respect to advisory services in some contexts; this underscores the lack of effective coordination between the two agencies.***

So under the proposal small IRA accounts generally would be cut off from personal investment assistance. This could have devastating effects, since it is advisers who encourage individuals to save, explain how IRAs work, explain how to open and maintain an IRA, explain investment diversification, and encourage individuals to stay in the market during down times and avoid the urge to sell low. In 2011, Oliver Wyman performed an extensive study of 40% of the IRA market, measuring the effect of the 2010 DOL proposal, which would have had the exact same effect as the 2015 DOL proposal. Oliver Wyman found that:

- Over 7 million IRAs could lose access to an investment professional (just within the study sample, which, as noted, was approximately 40% of the IRA market) because the brokerage model, which serves 98% of IRAs under \$25,000, would become unworkable with respect to IRAs.
- As many as 360,000 fewer IRAs could be opened every year.

Lessons from the United Kingdom. The defenders of the DOL proposal maintain that the industry would never walk away from servicing small accounts because there is too much money to be made. The view of such defenders is that somehow the industry will figure this out. That is a frightening basis on which to risk the retirement security of low and middle-income individuals: “if the brokerage model becomes illegal, industry will figure out some other way to service small accounts – we don’t know what it is, but they will figure it out.”

That is effectively what the regulators in the U.K. said before new rules took effect as of January 1, 2013 that had an effect almost identical to the effect the DOL’s prohibited transaction rules would have under the proposal – making payments from mutual funds to advisers illegal. Instead, advisers ceased servicing small accounts in droves, as shown below by a description of the January 1, 2013 results of the U.K.’s new rules. Some of these practices were implemented before the U.K. rule went into effect but clearly in anticipation of the rule, as recognized by a study commissioned by the U.K. regulator itself.

- **U.K.’s “big four” banks (an important source of investment advice in the U.K.)**
 - **HSBC:** provided investment advice only for customers with at least \$80,000² in total assets or \$160,000 of annual income.
 - **Lloyds:** provided face-to-face investment advice only for customers with at least \$160,000 in assets.
 - **Royal Bank of Scotland:** charged \$800 to set up a financial plan, and made changes to gear investment advice services to high net-worth clients.
 - **Barclays:** provides investment advice only for customers with at least \$800,000 in assets.

² The dollar references are approximate, based on 2013 pound to dollar conversion rates.

These banks previously had entire business arms or strategies providing investment advice to investors with less assets, but just prior to the U.K.'s implementation of its new rule, HSBC, Lloyds, and Barclays completely pulled out of offering investment advice to such investors, and, as noted, Royal Bank of Scotland overhauled its offerings to target high net-worth clients. For example, Barclays closed Barclays Financial Planning, leaving only Barclays Wealth to offer financial advice to individuals with at least \$800,000 in assets.

- **Examples of other actions taken.**
 - **Aviva:** ceased offering face-to-face investment advice.
 - **AXA:** ceased offering face-to-face investment advice.
 - **Adviser firm AWD Chase de Vere:** stopped accepting clients with \$80,000 or less in assets.
 - **Adviser firm Towry:** stopped accepting clients with less than \$160,000 in assets.
- **Millions of small investors will be told in the fall of 2016 that they will no longer be permitted to talk to their adviser.** The Oliver Wyman study lines up exactly with the experience in the United Kingdom and leaves us with a clear picture of the future under the DOL proposal. Based on DOL's time line, the applicability date for the new rules will very likely be some time around January 1, 2017 or slightly earlier. That means that in the fall of 2016 financial institutions will need to deliver the message to millions of small investors that they will no longer be permitted to consult with their adviser for assistance.

Meaningful assistance regarding rollover and distribution options would be prohibited. Under the DOL proposal, financial institutions would be prohibited from providing any specific assistance to individuals seeking help with the rollover and distribution process. This is the case in large part because any financial institution providing IRA services would have a conflict of interest with respect to advice regarding the rollover decision, thus creating a prohibited transaction. Most read the BICE in the proposal as not covering this type of assistance, thus rendering the assistance categorically prohibited. Others read the BICE as technically applicable to this assistance, but effectively unavailable because of the exemption's unworkable conditions. Either interpretation denies assistance to many in need of help in navigating the retirement savings options that exist after termination of employment. Among many unfortunate consequences, this would cause a drastic curtailment of call center, brokerage, and other assistance to those terminating employment, leading to greatly increased leakage of assets from the retirement system.

In fact, this prohibition of rollover assistance would apply without regard to whether the adviser is offering IRA services under a brokerage model or an advisory model. There has been a perception that advisers offering advisory services for a flat fee can advise participants to roll over to their IRA. This is incorrect. If an adviser promotes his or her own advisory services, that is fiduciary advice under the proposal. And it is a prohibited transaction because the adviser makes more money if the participant uses the adviser's services than someone else's. The flat fee element only applies to the advice provided to existing customers regarding investments; it does not apply to the choice of which adviser to use.

A study conducted by Quantria Strategies LLC found that the prohibitions described above could increase annual cash-outs of retirement savings for employees terminating employment by \$20 billion to \$32 billion. These withdrawals could reduce the accumulated retirement savings of affected employees by 20% to 40%.

It is important to note two additional points. First, there is already a robust regulatory scheme applicable to rollovers, applied by both the SEC and FINRA. In late 2013, for example, FINRA issued Notice 13-45, which addressed (1) IRA rollovers and (2) marketing IRAs and associated services. Here are some key points from the Notice:

- Reviewing firm practices in this area will be an “examination priority” for FINRA in 2014.
- The Notice discusses a number of compliance issues, including:
 - Firms must supervise IRA-related services to ensure that conflicts of interest do not adversely affect the services rendered.
 - The Notice is aimed at mitigating such conflicts by requiring representatives of member firms to provide information in a fair and balanced manner. For example, the Notice describes the four distribution options available to participants (e.g., maintain assets in the plan, roll over to an IRA, roll over to a successor plan if possible, or receive a cash distribution) and lists seven factors that may be of importance to a rollover decision. Conformity with these practices is included in the scope of FINRA regulatory examinations.
 - Broker/dealers must have a reasonable basis to believe that recommendations are suitable.
 - Broker/dealers must have written supervisory procedures designed to ensure compliance with applicable securities laws and FINRA rules.
 - Firms must ensure that registered representatives who advise on rollovers are adequately trained in that regard.
 - Communications must be fair and balanced.

Again, for 2015, as noted in FINRA’s 2015 Regulatory and Examination Priorities Letter, the rollover issue will be an area of focus for FINRA:

Part of FINRA's focus will be IRAs, one of the principal vehicles Americans use to save for their retirement. According to the Investment Company Institute, over one-quarter of Americans' retirement savings are held in IRAs and this percentage is growing. Rollovers from employer plans—such as 401(k) plans—play an important role in funding these IRAs.⁸ FINRA has stated that, whether in retail communications or an oral marketing campaign, it would be false and misleading to imply that a retiree's only choice, or only sound choice, is to roll over plan assets to an IRA sponsored by the broker-dealer.⁹ Any communications that discuss IRA fees must be fair and balanced,¹⁰ and the broker-dealer may not claim that its IRAs are “free” or carry “no fee” when the investor will incur costs related to the account, account investments or both.

Moreover, in the same 2015 letter, FINRA interpreted its rules to require that customers’ interest be put first.

Second, because the industry is committed to putting customers' interests first, if advice is provided with respect to distributions or rollovers, we completely support the view that the advice should be in the recipient's best interest.

Elimination of the ability of financial professionals to continue to provide meaningful investment education. The DOL proposal would significantly restrict the type of investment education that can be provided without triggering fiduciary status and the prohibited transaction rules. Under current law, education includes (1) guidance on the extent to which an individual should invest in different asset classes (such as large and small cap equity funds, and long and short-term bond funds) based on her age and other factors, and (2) examples of investments that fit within such asset classes. This definition of education has worked very well for nearly 20 years, ensuring that a basic level of needed assistance can be available to retirement investors often with no cost. Moreover, this definition was explicitly preserved under DOL's 2010 proposal. Under the 2015 proposal, however, providing examples of investments that fit within asset classes would be fiduciary advice, not education. Thus, education would be limited to conversations about investment theory that will be of little use to most retirement savers. As a result, we will have less informed plan participants who will be less able to put investment education to practical use and will be much less able to make informed decisions about investing their IRA and 401(k) account assets.

Prohibition on promoting your own products, services, or yourself. With respect to individuals and small businesses, the proposal provides no seller's exception from the fiduciary definition, unlike the 2010 DOL proposal. So individualized marketing to individuals and small businesses would be treated as fiduciary advice. DOL's rationale for this is the following: "Most retail investors and many small plan sponsors are not financial experts, are unaware of the magnitude and impact of conflicts of interest, and are unable effectively to assess the quality of the advice they receive." This position is directly contrary to the structure of ERISA and to DOL enforcement positions, which place a fiduciary duty on small employers to make prudent fiduciary decisions. It is also contrary to the very premise of the disclosure-based regime enacted by Congress to regulate broker/dealers. And it is also cutting off marketing to individuals. The DOL's view seems to be that individuals are unable to process marketing. But if individuals are unable to process marketing, how are they expected to make decisions?

- **Effect of absence of seller's exception.** Let's translate the lack of a seller's exception into real terms with a few examples. One could argue that these results were not intended, but after a four and a half year debate about the need for a seller's exception, and the nature of any such exception, concern levels are high.
 - **Prohibition on promoting a company's own products or services.** A company should be permitted to market its own products and services if it is made completely clear that the company is not providing advice but is selling a product or a service. Unfortunately, under the proposal, such promotion is prohibited with respect to individuals and small plans. Almost any discussion of a company's own products or services with any individual or small business plan is a fiduciary discussion. The result is that companies would be prohibited by the prohibited transaction rules from, for example, promoting their own services, such as

rollover services or managed account services, even in connection with a request for proposal (“RFP”). (Responses to RFPs can also include examples of advice that might be given by the responder, an issue addressed later in this letter.)

- **Interviews to be hired.** Assume that a broker is interviewing with a prospective customer and asking that she be hired to help with the customer’s IRA. She talks about her firm and her hard work and her dedication to her customers. She does not make any investment recommendations. Under the proposal, the broker is acting as a fiduciary. In fact, the individual would actually be committing a prohibited transaction by recommending that she be chosen. Obviously, that is an absurd result, but the fact that this result is inherent in the structure of the proposal says a lot about how overly broad the proposal is.
- **How do we know the difference between the results that are not intended and the results that may be intended?** It is not enough to say that the above examples were not intended and cannot be the law. There is no hint in the proposal regarding what promotion by a financial services provider is permissible and what promotion is prohibited, leaving all of us to make guesses. Unfortunately, this lack of clarity is built into the structure of the proposal.

ADDITIONAL ANALYSIS AND CONCERNS

The BICE is unusable. Initially, there was hope that the BICE would address many of the concerns that had been raised with respect to the original 2010 proposal. For many reasons, however, as noted above, the BICE is unusable. For example:

- **The BICE does not even apply to advice provided to small businesses.** With rare exceptions, small business 401(k) plans permit employees to direct the investment of their own account. The BICE does not apply to advice provided with respect to any such plan.
- **The BICE only applies if a contract is entered into before discussions begin.** So if an individual wants to interview different advisers, the individual would have to enter into contracts with all those advisers before talking to them, which simply would not happen.
- **The BICE only applies to individual advisers who sign a contract.** So if an individual adviser is on vacation or leaves her employer, a new contract would be needed.
- **The BICE does not apply at all to advice regarding services** (such as recommendations of advisers and advisory solutions, including managed account or “wrap programs” which combine investment management with brokerage services) and even if it did apply, it would be unworkable with respect to such services.
- **The BICE requires disclosure of an unimaginable amount of detailed information.** The adviser’s company must maintain a webpage with detailed information – updated at least quarterly -- about all direct and indirect compensation payable to the adviser, his company, and all company affiliates with respect to *every single asset* purchased, sold, or held by a retirement customer during the last 365 days (excluding only certain assets not commonly purchased). In addition, the webpage must include the same information about *all assets that a retirement customer could possibly purchase (subject to the*

same exclusion). It is hard to imagine that almost anyone would be able to process this staggering amount of data, which would be extremely costly to provide.

- **Inconsistent with existing DOL rules.** Every year, the adviser must provide information to the customer about that year's transactions, including the total dollar amount of all indirect compensation received by the adviser and his company during the year attributable to the customer. Systems do not exist that could produce this data and would take years to build, at great cost. Also, this data is very different from existing DOL requirements about disclosing indirect compensation.
- **Litigation.** The BICE effectively outsources enforcement of the prohibited transaction rules to the plaintiffs' bar, including new class actions under state law. This is an enormous change with frightening possibilities for the potential liabilities that could occur by reason of providing retirement services.
- **Predictions of future investment performance required.** Before a recommended purchase of an asset is made, the adviser must provide a chart to the customer with the "Total Cost" of the asset over 1, 5, and 10 year periods, as a dollar amount, *which requires the adviser to make assumptions about future investment performance, a task that is fraught with uncertainty and the potential for controversy and litigation.* In addition, the fact that this information is required before a transaction will dramatically slow the execution of trades, causing investors to systematically lose trading opportunities. And there are serious questions about the fundamental workability of making these projections based on the value of an asset that is changing as the projection is being prepared.
- **Concerns expressed by the main regulator of broker/dealers.** Rick Ketchum, the CEO of FINRA (which regulates broker/dealers) has spoken out strongly against the BICE:
 - Ketchum, May 27 speech: "I would like to . . . explain why . . . I believe moving to a properly designed best interests standard is a must going forward. Why, notwithstanding their good faith intentions, I believe the current Labor proposal is not the appropriate way to meet that goal . . ."
 - Ketchum, May 27 speech: "I fear that the uncertainties stemming from contractual analysis and the shortage of useful guidance will lead many firms to close their IRA business entirely or substantially constrain the clients that they will serve. Put another way, the subjective language of the PTE [i.e., the BICE], coupled with a shortage of realistic guidance, may lead to few providers of these critical investor services."
 - In an apparent reference to the BICE, Ketchum is reported in a May 1 Politico article to have stated that the "safe harbor" is "very narrow" and doesn't "describe any broker-dealer model that I'm aware of."

There is no way to comply with the applicability date. The proposal provides eight months for businesses to analyze and understand lengthy final regulations and exemptions that we have not yet seen, make business decisions that affect the entire retirement business, restructure that business, revise compensation packages and structures for advisers, renegotiate fee arrangements, design and implement company policies and procedures, create and modify systems to produce an unprecedented amount of new data, draft contracts for IRA owners across

the country, and enter into contracts with tens of millions of existing customers. That would take a minimum of three years, if it is feasible at all; eight months is simply not realistic.

- **Feasibility of entering into contracts with all existing customers.** A financial institution has no way to compel existing customers who are not actively using their services to enter into any contract. So not only is the applicability date unrealistic, the entire contract requirement is problematic as a transition matter.
- **Transition rule inadequate.** The proposed transition rule protects assets purchased by the applicability date. But it does not protect (1) assets purchased after the applicability date pursuant to advice given before the applicability date, or (2) advice provided after the applicability date that was paid for before the applicability date, which it clearly should.

Insurer promotion of its own health, life, and disability products. The proposal would convert the promotion by an insurer (or its agent) of the insurer's own group health,³ life, and disability insurance products to small businesses (or their fiduciary, such as a broker) or employees (of employers of any size) into fiduciary acts even in circumstances where no plan assets are held in trust. In other words, an insurer would be treated as a fiduciary with respect to certain welfare benefit plans simply by reason of promoting its own products.

If the promotion of these insurance products to small businesses (or their broker/fiduciary) or employees does become a fiduciary act, (1) the insurer would be vulnerable to a lawsuit simply for selling its own product without sufficiently considering the advantages of competitors' products, and (2) it is unclear whether a prohibited transaction exemption would be available to permit the continued sale by an insurer of its own insurance products to small businesses.

This result might seem counterintuitive, especially because DOL did not, in the preamble to the proposal, address this issue or provide any analysis of the economic effects of this aspect of the proposal. Nonetheless, DOL's proposal applies to the sale of common employment-based insurance. There are several steps in the analysis of this issue.

- **The ERISA definition of "fiduciary" applies by its terms to both retirement plans and welfare benefit plans.** Under ERISA, the term "fiduciary" applies by its terms to all types of plans, including both retirement plans and welfare plans. Moreover, the DOL proposal explicitly defines a "plan" covered by the fiduciary proposal as including both retirement plans and welfare benefit plans. See § 2510.3-21(f)(2)(i).
- **The DOL proposal applies to any "recommendation as to the advisability of acquiring . . . securities or other property."** Under the proposal and generally, it is clear that insurance contracts are "property." For example, the DOL proposal uses the term "Asset" to refer to a specific subset of property both covered by the new definition

³ All references herein to health insurance also include dental, vision, and other similar forms of health-related insurance coverage.

and eligible for an exemption. The term “Asset” is defined to include insurance contracts. See Section VIII(c) of the BICE.

- **The DOL proposal only applies to advice regarding the property of a plan or IRA; this requirement is satisfied too.** Under longstanding DOL rules, if employees contribute toward the cost of benefits, such as health, life, or disability insurance, the employee contributions are considered property of a welfare benefit plan, even if the contributions are not held in trust. See 29 C.F.R. § 2510.3-102; DOL Advisory Opinion 96-12A. Thus, in every case where employees contribute to the cost of a plan, advice regarding the insurance products is advice regarding the property of a plan.
- **The advice is rendered for a fee.** Under the definition of fiduciary investment advice, the advice must be rendered for a fee or other compensation, direct or indirect. The DOL has long taken the position that this does not require a separate fee for the advice; on the contrary, it is sufficient under DOL’s interpretation for the adviser to receive compensation in connection with the recommended transaction, as clearly occurs when an insurer receives premiums for health, life, or disability insurance.
- **The DOL proposal specifically treats individualized marketing to small plans and individuals as fiduciary advice, not as marketing.** Under the proposal, individualized marketing to large plans can be selling, not advising; individualized marketing to small plans and individuals cannot be selling, but rather is treated as investment advice. See § 2510.3-21(b)(1). DOL explains this rule in the preamble to the proposal: “in this retail market [for small plans and individuals], a seller’s carve-out would run the risk of creating a loophole that would result in the rule failing to improve consumer protections. . . .” It is this dramatic change in position, from both current law and the 2010 DOL proposal, that causes this issue to arise.

Let’s put the above points together in the context of a simple example. An insurer markets an array of health insurance products to employees of any size employer in a situation where employees are required to contribute toward the cost of the plan and can choose any of the products. The insurer, as expected, promotes the virtues of its products, as compared to its competitors’ products. Under the DOL proposal, this promotion is fiduciary advice because:

- Individualized marketing to an employee is advice under the proposal.
- The advice is for a fee, i.e., the premium that would be paid for the insurance.
- The advice relates to the acquisition of property, i.e., the insurance contract.
- The advice relates to the use of plan property, i.e., the employee contributions.
- The advice is specifically directed to the employee for her consideration.
- The advice relates to an ERISA plan, i.e., a health insurance plan.

DOL informally indicates that the above result was not intended. But the above result very clearly flows from the actual language of the proposal and is further evidence that the full adverse ramifications of the proposal are not fully understood, even by the DOL.

SECTION 2: RECOMMENDED CHANGES

THERE IS A VERY STRAIGHTFORWARD SOLUTION

After 4 ½ years and massive input, the DOL proposal got much worse between 2010 and 2015.

- The 2010 proposal preserved investment education; the 2015 proposal significantly restricts such education.
- The 2010 proposal permitted financial institutions to do direct marketing of their products to individuals and small businesses; the 2015 proposal does not.
- The 2010 proposal permitted financial institutions to provide meaningful distribution and rollover assistance; the 2015 proposal does not.
- The 2010 proposal did not provide any prohibited transaction relief; the 2015 proposal provides only unusable relief.
- There are very small improvements in the 2015 proposal, mostly addressing glaring glitches in the 2010 proposal, such as clarifying that ads on television are not fiduciary advice.

Specific recommendations for changes. DOL should not move forward with this seriously flawed rule, and instead should defer to Congress' decision to assign the SEC primary regulatory responsibility over broker/dealers and financial advisers. However, if a final rule is to be adopted, at a minimum, the following changes should be made.

- **Definition of fiduciary.** Under our proposed approach, the DOL's proposed definition of an investment advice fiduciary and the DOL's proposed exceptions to the definition would be modified in the manner described below. The result of our proposed solution is that the definition of an investment advice fiduciary would be broadened so that financial professionals providing personalized advice about investments or distributions would be required by law to act in the best interest of their customers.⁴
 - Investment or distribution advice would not give rise to fiduciary status unless there is a mutual understanding that the advice will be materially relied upon as a direction to engage in or refrain from taking a particular action. For example, casual discussions about investments or distributions that do not involve any expected material reliance would, of course, not give rise to fiduciary status.
 - As another example, advice provided in a response to an RFP is not expected to be relied on by either party; it is simply a way of illustrating the responder's capability. Under the proposal, all such responders to RFPs would become fiduciaries with respect to non-customers, and generally would be committing a prohibited transaction. Under our approach, that inappropriate result would be addressed.
- **Exceptions.** Under DOL's proposal, there are specific exceptions from the definition of a fiduciary for the following: selling, swap transactions, employees of a plan sponsor providing advice to a fiduciary, providers of platforms of investment options, asset valuations, and investment education. Under our approach, these exceptions would be preserved in the regulations with the following modifications:

⁴ As discussed below, we do not believe that DOL has any authority to treat distribution advice as fiduciary advice or to regulate IRAs. If those issues are resolved correctly, our recommended approach would be modified accordingly.

- **Permitting providers to sell their own products and services as non-fiduciaries.** Financial professionals who make it clear that they are selling products or services and not advising would not be considered fiduciaries under our approach. This commonsense exception was in the original 2010 DOL proposal with respect to products, but was explicitly limited to sales to large plan sponsors in the 2015 proposal. All categories of employees, agents, and registered representatives of selling entities could be sellers under our proposed rule, as well as business entities.
 - Also, the seller’s exception would not preclude the provision of incidental advice, provided that the appropriate disclosures are made regarding the fact that the entity or individual is acting as a seller. Selling activity can almost inevitably include some amount of incidental advice to use the product or service being sold; as long as it is made clear that this is part of the selling process, this should be treated as non-fiduciary selling.
 - This expansion of the seller’s exception is needed for many reasons. For example, it is critical that investment managers and advisers be permitted to promote services and products, such as managed account strategies and wrap programs. If this is effectively prohibited, very valuable services will become underutilized, harming the very people that DOL is trying to help.
- **Preserving education.** DOL guidance in Interpretive Bulletin 96-1 established an important line between “investment education” provided to plan participants, which does not trigger fiduciary status, and “investment advice,” which gives rise to fiduciary duties and triggers the prohibited transaction rules. This extremely helpful guidance, which was preserved in the 2010 DOL proposal but not in the 2015 proposal, has led to the wide availability of helpful information to plan participants. The original DOL proposal and our recommended approach, unlike the 2015 proposal, would continue to allow education to include the provision of examples of investment alternatives within asset classes. As under the proposal, our approach would also codify the existing education/advice distinction with respect to additional areas, i.e., education provided to plan sponsors and IRA owners, and education regarding distributions and rollovers (including distribution or rollover education that does not pertain to particular securities or other property or to the management of such securities or other property).
 - This type of education is extremely important to the millions of self-directed investors who seek non-fiduciary assistance. The ability to identify specific investment alternatives is critical; without this education component, discussions and materials with respect to asset classes are very unlikely to be helpful to individuals.
 - For example, this type of education is often provided through on-line tools and information. For many self-directed investors, who specifically do not want to pay a fee for investment advisory services, these tools are critical, and the provision of examples of specific investments through these tools makes the education meaningful for the investor. Without such tools and information, these self-directed investors will not have the information necessary to make sound investing decisions and will be forced into either making uninformed decisions or paying for services they do not want.

- Moreover, FINRA has specifically addressed these tools in NASD Notice 01-23, which provides guidance on when such tools can be viewed as a “recommendation” subject to applicable FINRA rules.
- Specific regulatory language to codify the current-law rules regarding education of plan sponsors is included in Appendix A.
 - **Platform exception.** This exception, which applies only to plans under the DOL proposal, permits service providers to offer plans menus of available investment options without being treated as endorsing all such options as a fiduciary. The exception would be extended under our approach to apply to IRAs and all types of retirement plans (or portions thereof, such as self-directed brokerage accounts), including (1) defined benefit plans, and (2) defined contribution plans without regard to whether they permit the participants to direct the investment of plan assets. This exception would also apply to recommendations of platforms by a third party.
 - **Asset valuations.** Generally, the DOL proposal would make asset valuations a fiduciary act. However, the proposal creates exceptions for ESOP valuations and certain other valuations (such as for reporting and disclosure). But the proposal continues to subject to fiduciary requirements countless routine valuation functions, such as valuing common assets (e.g., annuity contracts) for purposes of making distributions to participants. There is no apparent purpose for this requirement, nor any public policy issue that has been identified. Imposing fiduciary obligations on routine valuations would cause costs to rise dramatically and would pose unprecedented questions for appraisers about how to comply with their fiduciary duty. Asset valuations should simply be objective and accurate. Thus, our recommended approach would continue the current-law treatment of asset valuations as non-fiduciary acts.
 - **Best interest standard applies.** Under ERISA, financial professionals treated as fiduciaries are required to act in the best interest of their retirement customers. Under our recommended approach, as a condition of the prohibited transaction exemption described below, investment advice provided to IRAs (and other non-ERISA arrangements covered by the DOL proposal) must meet a best interest standard.
 - Our recommended approach would also include certain clarifications, including (1) clarifying that the sale of proprietary products or a limited range of products can be consistent with a best interest standard and is not an indication of a violation of the adviser’s fiduciary duty, and (2) clarifying that the structure or nature of the compensation of the adviser (or the financial institution) – such as compensation variations based on the investment made -- is not an indication of a breach of fiduciary duty. These clarifications are consistent with the proposal.
 - In addition, any transaction or arrangement that complies with the conditions of a prohibited transaction exemption would not be an indication of a breach of fiduciary duty.
 - **Ongoing fiduciary duty or duty limited to a specific transaction.** Under our approach, any adviser may, through clear disclosure, define the scope of his or her fiduciary duty, including whether the adviser has an ongoing duty to advise or whether the fiduciary advice was rendered with respect to a discrete time and transaction.

- **Preservation of investor access and choice.** Under our approach, consumer access to all forms of investment assistance, services, and products (subject to securities and insurance laws) would be preserved. This would be achieved by providing an exemption from the prohibited transaction rules with respect to all advice to all advice recipients regarding both assets and services, unlike the BICE, which is artificially limited to assets and to certain advice recipients. The application of our proposed exemption would be conditioned on (1) the advice being in the customer's best interest, (2) clear disclosure of material conflicts of interest, so that customers can understand the financial incentives of the adviser and the adviser's employer, and (3) the absence of any misleading statements.
 - Such disclosures would be based on the very effective and workable structure established by DOL under ERISA section 408(b)(2). Embedded in the 408(b)(2) disclosure regime is a recognition that disclosures regarding services and assets are different, so that this would work very well for an exemption applicable to both.
- **Effective date.** Under our approach, the proposal would become applicable three years after finalization. An entire industry cannot be restructured in eight months. In addition, we would provide appropriate transition rules regarding the proposal, including (1) a provision under which the proposal would not apply to any advice provided prior to the effective date, nor to any direct or indirect fees or other compensation received in connection with such advice, (2) a provision under which the proposal would not apply to any advice provided after the applicability date to the extent that such advice gives rise only to any compensation that would have been paid without regard to the advice, and (3) a provision under which the proposal would not apply to advice that was pre-paid for prior to the applicability date.

SECTION 3: THE PROPOSAL GOES FAR BEYOND THE STATUTE AND IS THUS BROADLY INVALID

The prior discussions are premised on the notion that DOL has the statutory authority to issue the proposal as a regulation. In fact, that is not the case.

Here is the statutory language in ERISA section 3(21) that DOL is interpreting in the proposal: "a person is a fiduciary with respect to a plan to the extent . . . (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so". The proposal goes far beyond this statutory language and is thus broadly invalid. The following are some specific examples.

THERE IS NO BASIS IN THE STATUTE FOR TREATING SALES ACTIVITY AS FIDUCIARY ADVICE

Under the proposal, individualized promotion of products or services to an individual or small business is fiduciary advice, even if the seller makes it clear that he or she is selling, not advising, and that is understood by the recipient of the promotion. In other words, (1) the seller makes it clear that he or she is selling and not providing investment advice, and (2) the recipient fully understands that the seller is selling, not providing investment advice. But the proposal still

treats the seller as a fiduciary. There is no way to reconcile this treatment with a statute that requires the rendering of “investment advice” to be a fiduciary.

For example, under the proposal, a salesperson who makes the following sales pitch to an IRA owner is treated as a fiduciary: “I work for the XYZ mutual fund family and I just wanted to help you become more familiar with our offerings. We offer a wide variety of funds and services that we think you would be very happy with. For example, our target date funds have been the highest rated target date funds for the last three years, and provide an excellent way to pursue a secure retirement. We have been in business for X years and work very hard to earn our customers’ trust every day. I am not authorized to give you advice but I am happy to explain our products and services to you.” Under the statute, that is clearly not investment advice, but it is under the proposal. DOL has no power to go so far beyond the statute.

Moreover, assume that an IRA owner is considering hiring an investment manager and asks to interview five possible managers. The interviews would be individualized promotion of investment services and thus trigger fiduciary status under the proposal. This clearly inappropriate result is required by the proposal but cannot be reconciled with the statute, which requires the rendering of investment advice.

THERE IS NO BASIS IN THE STATUTE TO TREAT A PERSON AS A FIDUCIARY BASED ON CASUAL DISCUSSIONS THAT ARE NOT VIEWED AS ADVICE BY ANY PARTY

Under the proposal, the threshold for fiduciary treatment is extraordinarily low: a communication regarding plan or IRA investments or distributions is treated as fiduciary advice if the communication is individualized to or specifically directed to a person and:

- (1) It “would reasonably be viewed as a suggestion,”
- (2) It is provided “for consideration.”

It is hard to reconcile this aspect of the proposal with the statute, which requires the furnishing of “investment advice for a fee” to trigger fiduciary status. Under the proposal, a mild statement that is reasonably viewed as a suggestion triggers fiduciary status, even if neither party views the statement as investment advice. Such a rule cannot be reconciled with a statute that requires the rendering of investment advice for a fee to trigger fiduciary status.

For example, assume that a participant researches how best to invest his plan assets, makes decisions, and casually asks a colleague in the human resources department if his investments look like what others are doing. The human resources employee responds by saying that he or she has no investment expertise at all, but the choices do seem similar to what others are making. That mild statement that the choices are in the mainstream is provided for consideration and thus triggers fiduciary status under DOL’s proposal. This cannot be reconciled with a statute that requires “investment advice for a fee” to trigger fiduciary status. Nor can this be reconciled with an ERISA statutory structure under which fiduciary duties are the highest possible duties under the law: (1) the duty to act as a prudent expert in the sole interest of the

advice recipient, and (2) the duty to avoid even the faintest hint of a conflict of interest (barring an exemption).

Under another example, assume that an IRA owner wants to invest some of her IRA assets in a large cap fund, and asks a financial professional who works for the IRA custodian for examples of large cap funds. The financial professional provides 25 examples. That is fiduciary advice under the proposal. For the same reasons noted above, there is no way to get to this result under the statute.

DOL HAS NO AUTHORITY UNDER THE STATUTE TO TREAT DISTRIBUTION ADVICE AS INVESTMENT ADVICE

The DOL has no authority under the statute to treat advice regarding whether to take a distribution as “investment advice”. Assume, for example, that an adviser advises a participant to take a distribution of her plan account and roll into an IRA but expresses no opinion on whether the participant should roll over her plan holdings into the IRA or should liquidate the plan holdings and invest in different assets in the IRA. How could this possibly be treated as investment advice regarding plan assets?

In fact, the DOL has squarely recognized this limitation on the scope of investment advice in DOL Advisory Opinion 2005-23A, which states:

It is the view of the Department that merely advising a plan participant to take an otherwise permissible plan distribution, even when that advice is combined with a recommendation as to how the distribution should be invested, does not constitute “investment advice” within the meaning of the regulation (29 CFR § 2510-3.21(c)).⁽³⁾ The investment advice regulation defines when a person is a fiduciary by virtue of providing investment advice with respect to the assets of an employee benefit plan. The Department does not view a recommendation to take a distribution as advice or a recommendation concerning a particular investment (*i.e.*, purchasing or selling securities or other property) as contemplated by regulation § 2510.3-21(c)(1)(i). Any investment recommendation regarding the proceeds of a distribution would be advice with respect to funds that are no longer assets of the plan.⁽⁴⁾

In our view, Advisory Opinion 2005-23A remains the correct interpretation of the statute. Nothing has changed, except the public policy view of the DOL, which apparently now believes that participants should generally not roll over assets to an IRA.

The preamble to the proposal makes it very clear that DOL believes that “[p]articipants will often, but not always, be better off leaving their balance in the plan than rolling it into an IRA”. DRIA at 224. Also, on page 145 of the DRIA, DOL states that “[g]iven the structural advantages of retirement plans – large investible asset balances may provide access to better asset management and lower cost – plan participants often can expect lower net returns after rolling their account into an IRA.”

Whether the law should favor plans or IRAs is clearly a policy point that is outside the interpretive authority of DOL. *Nevertheless, DOL has reached its own policy conclusion and*

ignored both the statute and its own interpretation of the law to issue a proposal that it has no authority to issue with respect to distribution advice.

DOL HAS NO POWER TO REGULATE IRAs BUT HAS DONE EXACTLY THAT UNDER THE “BEST INTEREST CONTRACT EXEMPTION”

Assume that DOL were to issue a regulation that directly imposes a series of regulatory requirements on IRAs, such as (1) disclosure rules, (2) a requirement that contracts be entered into with IRA owners, and (3) restrictions on the types of compensation that can be paid to IRA advisers. Legal analysts would agree that DOL has no such authority over IRAs and that the regulatory requirements would be invalid.

Yet that is exactly what DOL has done here indirectly. The first step is to issue a proposal under which all broker/dealers become fiduciaries as to IRAs and because of the structure of their compensation need a prohibited transaction exemption in order to provide services to IRAs. The next step is to impose a comprehensive regulatory regime on IRA advice as a condition of satisfying the exemption. Thus, any broker/dealer wishing to continue providing IRA services must comply with DOL’s comprehensive regulatory regime. DOL is clearly regulating IRAs in a way that it has no authority to do.

SECTION 4: DOL’S ECONOMIC ANALYSIS, CONTRASTED WITH THE ACTUAL EFFECTS OF THE PROPOSAL

One theme is consistent throughout the DRIA, which is that it reads like a brief prepared by an advocate who is retained to defend the DOL proposal. Accordingly, in many cases, like those discussed below, the DRIA does not include points that undermine the proposal, and sometimes makes statements that appear to be inconsistent with the facts. In addition, there are many instances, such as the education restriction, where the DRIA does not explore the possible adverse effects of the proposal or possible more flexible ways to achieve DOL’s stated objectives.

DOL’s proposal would result in annual lost retirement savings of \$68-80 billion. Attached is a study prepared by Quantria Strategies, LLC, staffed by a former Deputy Chief of Staff and a former economist for Congress’ Joint Committee on Taxation. The study is entitled “Unintended Consequences: Potential of the Dol Regulations to Reduce Financial Advice and Retirement Readiness.” The study concludes that:

Conservative estimates of the combined reduction in retirement assets attributable to the unintended consequences of the re-proposed regulations suggest that the regulations could result in losses of retirement savings of \$68-\$80 billion each year. In addition, the re-proposed regulations will jeopardize retirement readiness for 11.9 million IRA and retirement participants. This 11.9 million figure is made up of individuals who either are unlikely to be retirement ready (6.1 million) or are at risk of failing to be retirement ready (an additional 5.8 million).

DOL’s analysis of the cost of “conflicted advice” is based on unfounded assumptions and erroneous analysis. Quantria Strategies prepared a second study (attached), which reviews the DOL economic analysis, entitled “Critical Review of DOL Regulatory Impact Analysis”. The study concludes that:

1. *DOL fails to incorporate any estimates of the positive benefits of financial advice*, even though the DOL admits that there may be “observable or intangible” benefits to using a broker-dealer and despite the fact that DOL previously estimated that retirement plan participants made investment mistakes of approximately \$114 billion in 2010 due in large part to the lack of financial advice.
2. DOL *claims that front-end load mutual funds “underperform”* by 100-200 basis points per year, but the academic research DOL cites and additional data analysis show that *these claims cannot be supported.*
3. *DOL regulatory impact analysis cites numerous supporting studies that*, upon closer scrutiny, often *qualify their findings* with caveats concerning the findings and suggestions for further research.
4. DOL’s *compliance cost estimates likely significantly underestimate the actual costs* and fail to account for the fact that these costs will be borne by consumers.
5. DOL assumes that *financial advisers will accept reduced fees without any change in either the quantity or quality of their investment advice*, but basic economic analysis suggests that this assumption cannot be supported.

A 2011 DOL analysis states very clearly that the prohibited transaction rules are “at least in part” responsible for over \$100 billion of losses per year; this occurs because those rules can preclude advice such as brokerage advice that runs afoul of those rules. Yet the 2015 DOL proposal massively broadens the application of those prohibited transaction rules without mentioning the 2011 analysis. In 2011, DOL finalized another regulation on investment advice. See Regulation § 2550.408g-1. That regulation provided prohibited transaction exemptions for two types of arrangements: (1) arrangements under which the adviser and the adviser’s employer receive level fees (but affiliates may receive differential pay based on the recommendation), and (2) arrangements providing advice through the use of a computer model. DOL’s preamble to this final regulation contained a very interesting discussion, making the following points.

- Even after the adoption of the 2011 rule, DOL estimates that annual retirement losses attributable to investment mistakes would be approximately \$101 billion per year. See 76 Fed. Reg. 206 (October 25, 2011) at 66153.
- *“Such mistakes and consequent losses historically can be attributed at least in part to provisions in the Employee Retirement Income Security Act of 1974 that effectively preclude a variety of arrangements whereby financial professionals might otherwise provide retirement plan participants with expert investment advice”, referring “[s]pecifically [to the] ‘prohibited transaction’ provisions of section 406 of ERISA and section 4975 of the Internal Revenue Code”. Id. at 66151.*

The 2011 DOL analysis states very clearly that the prohibited transaction rules are “at least in part” responsible for over \$100 billion of losses per year. Yet the 2015 DOL proposal

massively broadens the application of those prohibited transaction rules without ever even mentioning the 2011 analysis.

DOL never analyzed whether an eight-month transition period is sufficient.

Shockingly, DOL makes it clear that it never analyzed the economic effects of the applicability date, which is eight months after publication of the final rule. In other words, DOL never analyzed whether the entire financial advice industry can be restructured to be conformed to the new rules in eight months.

Here is DOL’s entire discussion of this issue in the DRIA (and there is no economic analysis of this issue in any other part of DOL’s proposal):

- “The Department understands that affected advisers and others in the financial industry will need time to modify business practices. A longer compliance period would defer and may reduce compliance costs, but would forgo large, near term gains to investors, which in turn could have long-term negative effects on investors’ retirement savings trajectories. The Department invites comments as to whether the new proposal’s compliance dates are workable, or whether dates should be adjusted with respect to some or all of the proposal’s provisions and entities and transactions it affects.” *In other words, the eight month transition period is not supported by any prior analysis.*
- *On the contrary, it appears from DOL’s public statements that the applicability date was chosen for political reasons, not based on any economic analysis.* For example, a BNA article quoted Secretary Perez as saying on June 23: “Completing this rule is one of the single most important things we can accomplish in the remaining 577 days. I’ve got a note on my desk: 577 days until the weekend, Jan. 20, 2017.”

DOL’s analysis of the IT costs of complying with the BICE demonstrates a lack of work on the issue. Here is what DOL stated in the preamble to the BICE:

- “The Department estimates that updating computer systems to create the required disclosures, insert the contract provisions into existing contracts, maintain the required records, and publish information on the Web site will require 100 hours of IT staff time for financial institutions during the first year that the financial institution uses the PTE.⁵⁴ This IT work results in approximately 280,000 hours of burden during the first year and approximately 22,000 hours of burden during subsequent years at an equivalent cost of \$22.3 million and \$1.8 million respectively.” 80 Fed. Reg. 75 (April 20, 2015) at 21982.
 - The only other analysis provided by the DOL was an overall cost estimate of the proposal based on private sector submissions made to the SEC with respect to the cost of a possible SEC uniform fiduciary standard, which did not contain anything remotely similar to the BICE. Instead of far increasing those estimates to take into account the enormous new burdens of the BICE, DOL concluded that those private sector submissions were too high, and dramatically reduced them without any apparent consideration of the cost of the many new burdens presented by the BICE.
- I asked major financial institutions about the number of hours and amount of money that they spent on implementing a far less burdensome set of DOL disclosure requirements:

the participant disclosure rules under Regulation § 2550.404a-5 and the service provider disclosure rules under § 2550.408b-2. Here are the answers I received:

- One company spent over 100,000 IT hours implementing the two existing requirements at a cost of approximately \$8.4 million.
- Another company spent over 90,000 hours at a cost of over \$6.5 million.
- ***Based on the information received, it appears that DOL's 100 hour estimate was likely off by several hundred thousand hours, which could translate into tens of millions of dollars per company.***
- There are many reasons that the BICE exemption requirements are far more burdensome than the disclosure requirements noted above. I will mention one of them. The BICE requires the disclosure of indirect costs in dollar terms to participants. No system exists today that could do that. Anecdotal evidence indicates that it would take years to create such a system, if it could be done at all, and at great cost. It is indisputable that such a disclosure is far more burdensome than anything required under the two regulations (§§ 404a-5 and 408b-2) cited above.

DOL attributed *no cost* to any disruption caused by the need to enter into tens of millions of contracts with IRA owners in an eight-month period. On page 176 of the DRIA, the DOL noted that in its evaluation of the cost of BICE, that DOL's cost estimates "do not include time or disruption costs for the situation where phone interactions between advisers and investors are interrupted (or switched entirely to e-mail, print or in-person) in order to first sign the contract." The rationale was that the eight-month transition period will result in all of this work being done ahead of time, except in "rare" instances.

DOL's analysis of this point in one brief sentence overlooks a mountain of issues. For example, let's examine the number of contracts involved. The attached 2011 Oliver Wyman study reflected data from 12 financial services firms, which held IRAs on behalf of a total of 19 million IRA owners, i.e., an average of approximately 1.58 million IRA owners per firm. There are approximately 243 days in an eight-month transition period, including weekends and holidays. Thus, in order to enter into contracts with all IRA owners during this period, the firms would *each* have to enter into an average of over 6,500 contracts per day. In one brief sentence without any evidence or analysis, DOL states that this should not be a problem. On the contrary, this would be an enormous problem, and it is a virtual certainty that a huge number of IRA owners would not have contracts at the end of the eight-month period.

DOL did not do any meaningful analysis of the workability of the BICE. On page 176 of the DRIA, DOL states that that the

Department expects that the proposed rule . . . to have little effect on access to investment advice. The proposed Best Interest Contract PTE extends substantial flexibility to advice providers to adopt the business models that allow them to best serve their clients, including the ability to continue receiving direct and indirect variable compensation, such as commissions and revenue-sharing payments.

In other words, DOL recognizes that the BICE is critical to avoiding an adverse effect on access to investment advice. But instead of examining the workability of the BICE, DOL simply asserts that it is sufficiently flexible.

In fact, the consensus among all or substantially all financial institutions and financial trade associations, as reflected in comments, is that the BICE is unworkable and cannot practically be used. Even if it could be used, there is no way to implement it in less than approximately three years. The DRIA contains no analysis of these issues.

DOL's analysis of call centers reflects a lack of understanding of call centers. On page 175 of the DRIA, the DOL states that call center personnel may need training on the new definition of education but "call center [sic] would not be fiduciary advisers and therefore are not otherwise affected by this proposal." This conclusory sentence, which is not supported by any analysis, is inconsistent with economic reality.

Under the current fiduciary definition, call center employees will generally not be fiduciaries because there will not be any mutual understanding of any reliance. Call center employees provide basic information about investments, distributions, and rollovers, but do not give advice, as noted by DOL itself. Under the new proposal, if one call center employee answers almost any question, he or she becomes a fiduciary and almost certainly will have engaged in a prohibited transaction. Answers to any of the following questions, for example, would give rise to fiduciary status:

- You mentioned large cap funds. What are large cap funds? Which of the funds in our plan are large cap funds?
- What do most people like me invest in?
- What do most people like me do with their account when they terminate employment?
- How should I go about figuring out which funds to invest in?
- Can you give me some information on how to contact IRA providers that have experience dealing with people like me?

Answering any of those questions would give rise to fiduciary status and likely a prohibited transaction. In that context, many financial institutions are actively discussing instructing their call centers not to engage at all with respect to investment or distribution questions. DOL did not analyze this issue at all, once again demonstrating that its economic analysis is severely incomplete.

DOL describes disclosure as either useless or counterproductive in its analysis of a regulation that requires more disclosure than any other DOL retirement regulation (at least in recent history), demonstrating a lack of relationship between the economic analysis and the actual proposal.

- Here are quotes from the DOL's analysis of the impact of disclosure:
 - "Nor are IRA owners likely to understand advisers' conflicts. Many ignore disclosures. Some others may react to disclosures in ways that exacerbate the problem." DRIA at 194.

- “[S]everal [representatives of brokerage firms] acknowledged that ‘investors rarely read these disclosures . . . [F]or many investors, the fact they were given disclosures was seen as meaningless.’ Burke et al. [sic] (2014) summarizes additional literature suggesting that retirement investors often fail to devote meaningful attention to relevant disclosures.” DRIA at 194.
- “Lowenstein, Cain, and Sah (2011) describe how disclosure of adviser conflict can “backfire . . . They might interpret disclosure as a sign of honesty”. DRIA at 194.
- “Given that investors are hard pressed to understand advisers’ conflicts or their implications, this suggests that disclosure of conflicts will be ineffective.”
- The above DOL analysis is not consistent with the fact that the proposal requires far more disclosure than any other retirement regulation or statute, at least in recent history. It is also in sharp conflict with the judgment made by Congress, embodied in the securities laws, that disclosure is an effective, central element of a regime for regulating financial investment.

Even the DRIA’s own analysis reflects the damage done by the very similar rule adopted in the United Kingdom. Our discussion in Section 1 of this letter provides facts showing that a very similar rule adopted in the U.K triggered a massive exodus of advisers from the small account market. The DRIA attempts to respond to these facts with statistics that are simply off point, such as discussions of the number of advisers who have met the qualifications prescribed by the U.K. rule, a fact unrelated to the issues at hand. And the DRIA cites aggregate statistics unrelated to the effects on small accounts. For example, the DRIA cites a Towers Watson study commissioned by the U.K. regulator itself, which “concludes that there is not an advice gap because there are sufficient advisers to meet the demand.” *This citation omits a key fact from the Towers Watson study, which states:*

“A different picture is likely to emerge in considering individual consumer markets, as opposed to the total market. . . .it has not been possible to analyse supply by segment. . . . However, anecdotal evidence . . . suggests that advice capacity serving less affluent segments is likely to have reduced.”

The omission of this crucial aspect of the Towers Watson study is a prime example of the point made at the outset of this Section of the letter: the DRIA appears to be more like a brief than a balanced presentation of the facts.

But still the facts come through, even in the DRIA. In fact, in trying to defend the U.K. rule, the DRIA actually highlights the severe problems with the U.K. rule with the following statement:

“The FCA [the U.K. regulator] reported that although a number of banks have exited from the investment advice market for small accounts, it is not accurate to point to the RDR as the main cause. For example, the letter states that Barclays exited the advice market even before the RDR was passed, due to “a decline in commercial viability for such services over recent years.” Although some of the banks have pulled out of the

investment advice market, FCA-commissioned research found that most retail investment advisers continue to serve clients with savings and investments between £20,000 and £75,000 and that a third of advisers continue to serve clients with less than £20,000. The FCA noted that the emergence of new ways to access advice using on-line technology has the potential to offer those with small amounts to invest an efficient and cost-effective means to receive advice.⁷² The report issued by Europe Economics in December of 2014 discusses that there are some indications that a number of banks are looking to re-enter the market, perhaps with more technology-supported applications.⁷³” [emphasis added]

This quote is a wealth of good information:

- First, it is amazing that the U.K. regulator’s best answer in defending its own regulation is that (1) although the regulation contributed to the exodus of advisers from small accounts, there were other factors at play as well, and (2) *one* bank allegedly exited the market for other reasons.
- ***But the most telling point is the bolded sentence, which reveals that roughly two thirds of advisers refuse to provide services to individuals with less than \$31,200 (the equivalent of 20,000 pounds). Why doesn’t DOL find this extremely troubling? Why didn’t DOL follow up on this point and find out how many advisers serve individuals with less than \$10,000? That is a critical issue and it was left completely unaddressed in the DRIA.***

The clear problem with access to advice for small accounts is even acknowledged by the U.. K. regulator, but DOL put this point in footnote 72 on page 45 of the DRIA and does not further discuss it:

In a July 2014 report, the FCA stated that it has been discussing with its stakeholders options for low-cost, simpler ways of recommending retail investment products, particularly for customers with relatively modest amounts to invest and relatively straightforward investment needs. The FCA acknowledged that it is clear that there has been some reluctance on the part of firms to develop these models and that it is seeking to understand more about the barriers firms believe they face.

Instead of discussing this concerning problem, here is DOL’s textual summary of the above statement by the FCA: “The FCA noted that the emergence of new ways to access advice using on-line technology has the potential to offer those with small amounts to invest an efficient and cost-effective means to receive advice.” Again, this is yet another striking example of the DOL’s dismissal of facts that could argue against the proposal.

Finally, DOL tries unsuccessfully to distinguish its proposal from the U.K. proposal. The U.K. proposal directly bans payments from mutual funds to advisers. DOL is correct that it does not directly ban such payments. But under the DOL proposal, such payments are only permitted under the unusable BICE, which is the equivalent of a ban.

DOL's response to the 2011 Oliver Wyman study contained factually incorrect statements, thus further undermining the DRIA. The April 12, 2011 Oliver Wyman study of the IRA market found that under the original 2010 DOL proposal:

- Over 7 million IRAs could lose access to an investment professional (just within the study sample, which, as noted, was approximately 40% of the IRA market) because the brokerage model, which serves 98% of IRAs under \$25,000, would become unworkable with respect to IRAs.
- As many as 360,000 fewer IRAs could be opened every year.

DOL's response to the study stated that:

“One comment in particular, which included the Oliver Wyman report, predicted major disruptions in the IRA market, including reduced savings by lower income households, appeared to have misunderstood important elements of that proposal. For example, it wrongly assumed that fiduciary advisers to IRA investors could not accept commissions, when in fact much of such compensation would have been permitted under PTE 86-128. It also wrongly assumed that such fiduciary IRA advisers would be liable for breaches of ERISA's fiduciary duties of prudence and loyalty, when in fact such liability existed only for plan advisers, not IRA advisers.”

DOL's response is simply incorrect, as demonstrated below:

- ***Oliver Wyman's explanation of the problem with the 2010 proposal does not address commissions, but rather focuses exclusively on indirect payments from mutual funds, making DOL's statement above inexplicable. And PTE 86-128 does not apply to indirect payments from mutual funds. Here is Oliver Wyman's explanation:***
 - *“As fiduciaries under the Department of Labor's proposed rule, firms and their associated representatives may not receive different levels of compensation based on the investment choices of retail investors in protected IRA accounts. However, the current brokerage model that has developed to serve IRA accounts is incompatible with this requirement, often involving both direct and indirect fees, such as shareholder servicing fees, sales and distribution fees, revenue-sharing and other fees. These fees frequently vary by product based on factors such as complexity, adviser time requirements (e.g. to explain the risks and benefits and determine client suitability), and services performed such as shareholder servicing.”*
- ***DOL states that Oliver Wyman assumed that IRA advisers would be liable for breaches of ERISA's fiduciary duties of prudence and loyalty. This is simply untrue. For example, a computer search of the Oliver Wyman report reveals that the terms “prudence” and “loyalty” are never used. Nothing in the Oliver Wyman report comes close to suggesting what DOL says.***
- ***Because the BICE is unusable, all of the problems highlighted in the Oliver Wyman study will occur, a point that was not addressed by the DRIA.***

DOL fails to mention statements in a study DOL commissioned that does not support the proposal. DOL's discussion in the DRIA was very critical of the Oliver Wyman study, but that discussion fails to mention that a study commissioned by DOL was unable to conclude that Oliver Wyman was wrong. See Garber, Burke, Hung, and Talley, "Potential Economic Effects on Individual Retirement Account Markets and Investors of DOL's Proposed Rule Concerning the Definition of a 'Fiduciary'", Rand Labor and Population, February 2015, Prepared for the Department of Labor. *On page 19 of this study, the authors evaluate the key Oliver Wyman findings and conclude that:*

We cannot assess these claims for two major reasons. First, we have no basis for gauging the extent of the adjustments that broker-dealers would have to make—which may include cost reductions, revenue increases, or both—to operate profitably if the Proposed Rule were adopted. Second, even if we did know how much broker-dealers would have to reduce costs, increase revenues, or both to operate profitably under the rule, we would have no basis for predicting whether the cost reductions would involve lesser availability of particular advisory services that currently are bundled in “commission-based” advisory relationships, such as those claimed in the four bullet points.

Similarly, DOL does not mention that the Rand study is “*unable to conclude whether any particular kind of investor would be made better or worse off by adoption of the rule.*”

The fact that DOL does not mention these points in its DRIA lends further support to the view that the DRIA more resembles an advocate's brief than a balanced assessment of the effects of the proposal.

DOL's response to a May 2014 small business survey conducted by Greenwald & Associates cannot withstand scrutiny. In May of 2014, Greenwald & Associates released a study of small business owners focusing on the effects of the prohibited transaction rules on small businesses if the DOL expands the definition of fiduciary. If the definition of a fiduciary is expanded as under the DOL proposal, current assistance provided to small businesses in setting up a retirement plan would give rise to fiduciary status, and thus trigger prohibited transaction rules that would preclude the assistance even if it is in the best interest of the small business. Because of the effect of the prohibited transaction rules, the survey found, for example, that:

- Almost 30% of small businesses with a plan indicated that it is at least somewhat likely that they would drop their plan if this regulation were to go into effect.
- Close to 50% of small businesses without a plan stated that the regulation would reduce the likelihood of them offering a plan, with 36% saying it would reduce the likelihood greatly.

DOL first criticized this survey by contrasting it with an AARP survey that “found that plan sponsors overwhelmingly support subjecting DC plan providers who advise participants to the fiduciary standard of loyalty.” This DOL criticism of the Greenwald survey is simply off point since the Greenwald survey did not have anything to do with the fiduciary duty of loyalty. The Greenwald survey merely examined small businesses' reactions to the effects of the

prohibited transaction rules, which under the DOL proposal, would preclude assistance that is in the participants' best interest.

DOL's second criticism of the Greenwald survey is inconsistent with DOL's own proposal. DOL says that its proposal simply requires adherence to a fiduciary standard and a duty of loyalty, and the DOL proposal does not contain applicable prohibitions in this area. This discussion is very odd in light of the prohibited transaction rules, which under the DOL proposal do exactly what the Greenwald study says.

Then the DRIA seems to shift focus and address the prohibited transaction rules, but DOL suggests that the prohibited transaction problems can be solved in two ways. First, the service provider could restructure its entire business model and give up all or substantially all of its revenue from the investments offered under the plan. This would avoid the prohibited transaction problem, but needless to say, is not commercially viable. And what is most striking is that there is not a single piece of analysis and not a single citation indicating that the DOL explored whether such a restructured business model could be viable.

Second, the DRIA makes the following statement. "Alternatively, the adviser or provider could take advantage of an existing or proposed PTE that permits variable and third-party compensation." *What is noteworthy here is that the DRIA could easily have provided examples of PTEs that could solve the problem if there were such PTEs. But no such examples are provided. In our view, no such PTEs exist, given that the BICE is both unusable and inapplicable to participant-directed small business plans.*

The DRIA's response to an April 2014 Quantria Strategies study lacks any substance. In April of 2014, Quantria Strategies issued a study showing that the prohibitions contained in the DOL proposal could increase annual cash-outs of retirement savings for employees terminating employment by \$20 billion to \$32 billion. These withdrawals could reduce the accumulated retirement savings of affected employees by 20% to 40%.

Instead of discussing the merits of the study, the DRIA's study starts off by simply quoting unsubstantiated criticisms of the study by proponents of the DOL proposal. For example, one blog says, without any analysis, that the study "assumes a false premise."

Next the DRIA poses several questions about the evidence underlying the study. Nowhere is it disclosed that our firm, which co-sponsored the study, sent written invitations to the DOL to send us any questions they have about the study, but no questions were ever sent. If the answers to the questions in the DRIA are important, it is hard to understand why DOL did not pursue those answers.

The DRIA goes on to make the following incorrect statement: "by explicitly extending guidance on the bounds of non-fiduciary education to cover education about distributions and rollovers, the new proposal is likely to make call center guidance more available and robust, not less." Actually, under DOL Advisory Opinion 2005-23A, advice regarding distributions and

rollovers from a call center would not make the call center a fiduciary under current law. But the proposal clearly can convert call centers into fiduciaries, as discussed above. So there is no basis for stating that the education guidance in the proposal would expand permissible education and thus free up call centers to provide more information.

Finally, DOL commissioned a third party to conduct a special study to review the Quantria study. We applaud the DOL for taking this step; that is exactly how an economic analysis should be conducted. However, the special study was seriously flawed. Please see Quantria's document discussing those flaws, which is attached.

In justifying its new rule applying the fiduciary rules to distribution and rollover advice, the DRIA relies heavily on a 2013 GAO report, but surprisingly omits one key element of that report that undermines the DOL proposal. The GAO report contains a striking inconsistency, which is not mentioned in the DRIA. GAO states in its report that:

for fear of incurring additional liability, plan sponsors and service providers may unnecessarily limit the education they provide to plan participants about their distribution options when separating from employment.

This is a clear, logical, and accurate point. If the provision of distribution information triggers potential fiduciary liability, there will obviously be less information provided. **The inconsistency in the report is that GAO then recommends that DOL finalize its fiduciary regulation, which would expand fiduciary liability and thus reduce access to critical information investors need to make a good decision.**

Page 48 of the report may shed some light on the inconsistency. Apparently, the initial draft of the GAO report was different on the fiduciary issue, but DOL appears to have expressed concerns. This is highlighted by the fact that GAO, in its discussion of DOL's comments on the GAO study, stated:

while we had previously pointed out that providers reluctant to become fiduciaries may limit the availability of investment advice as well as education to participants, we revised the section to better convey that upcoming clarification about the definition of a fiduciary, and about what constitutes investment advice and education, will help plan sponsors and providers understand what they can give to participants in different circumstances and should mitigate their concerns about assisting plan participants. The initial draft of the report was different with respect to the fiduciary issue.

This may explain the inconsistency. DOL apparently objected to the suggestion that fiduciary liability can chill the provision of distribution and rollover assistance, so GAO adopted the following illogical position. "If providers are concerned that they may have fiduciary liability, they will not provide information. But if DOL confirms that they do have fiduciary liability, they will provide information." This does not make sense. And GAO's report does not reflect the terms of the rules actually proposed by DOL.

The DRIA should have examined the inconsistency in the GAO report and explored the chilling effect of fiduciary status on the provision of information. But the DRIA did not explore this issue.

The DOL never measures the “intangible” effects of financial advice, but rather simply assumes that such benefits are not significant enough to affect the proposal. On the contrary, a very recent study shows striking benefits from financial advice. In “The role of financial advisors in the US retirement market” (July 10, 2015), Oliver Wyman finds that:

- Small businesses that work with a financial adviser are 50% more likely to set up a retirement plan (and micro business with 1-9 employees are almost twice as likely).
- Advised individuals, segmented by age and income, have a minimum of 25% more assets than non-advised individuals.
- In the case of individuals aged 65 and older with \$100,000 or less in annual income, advised individuals have an average of 113% more assets than non-advised investors.
- Advised investors have more diversified portfolios -- own twice as many asset classes, have more balanced portfolio asset allocations and use more packaged products for equity exposure compared with non-advised investors.
- Advised investors stay more invested in the market – advised individuals hold less cash in their investment accounts (36%-57% less than non-advised individuals for similar age and wealth cohorts).
- Advised investors re-balance more frequently, and are 42% more likely to re-balance their portfolios at least every two years.

It is a failure of the DRIA not to have attempted to measure these effects, as Oliver Wyman did.

The DRIA devotes no time to determining the possible adverse effects of the proposal’s restrictions on investment education. On pages 143-144 and 154 of the DRIA, DOL discusses the proposal’s radical cutback in investment education permitted, i.e., not allowing educators to provide examples of investments within asset classes, but provides no economic analysis.

- There is no analysis of the effect on participants who may be told that they should be invested, for example, 40% in large cap funds. If such participants do not know what a large cap fund is and ask for examples, no such examples can be given. The DRIA does not consider the effect of this lack of information on participants.
- Moreover, the DRIA fails to even consider the advisability of alternatives to a complete ban on examples. One of the cardinal rules of regulation-writing is that regulators should look for less restrictive ways to achieve the same goals. Why is there no discussion of ways to ensure that the examples provided do not improperly steer participants if that is DOL’s objective? This type of issue was never even mentioned.

The DOL does not do any analysis of the harmful effects of the inconsistency between the rules applicable to different retail accounts. Under the proposal, the prohibited transaction rules and best interest standard (under the BICE) would apply to advice regarding IRAs, while, under securities rules, a suitability standard would apply to advice regarding non-retirement accounts. This lack of consistency can have very adverse results. *The DRIA does not even mention these possible adverse results, much less analyze them.*

- **Advice focused on non-retirement accounts.** As discussed above, the brokerage model will generally be illegal with respect to IRAs because the BICE is unusable, an issue never examined by the DOL. So broker/dealers will generally be precluded from helping individuals with their IRAs. But no such prohibition exists with respect to non-retirement accounts. So broker/dealers who have traditionally encouraged clients to save through an IRA will be effectively forced to focus their energies on non-retirement accounts because they are prohibited from working on IRA investments. Thus, it is only logical that far fewer IRAs will be opened every year, as found by the 2011 Oliver Wyman study, and far fewer IRA contributions will be made. Yet the DRIA does not even mention this issue.
- **Investor confusion.** Another problem of great concern to broker/dealers is the fact that they could be held to have provided prohibited advice without knowing it. For example, assume that a customer comes to a broker/dealer for help with a \$25,000 non-retirement account. The broker/dealer provides some ideas for investing the account, but prudently requires the customer sign an agreement that the customer will not consider this assistance in making decisions about how to invest his IRA assets. In order to protect themselves against lawsuits and prohibited transactions, broker/dealers will almost inevitably require such agreements.
 - Any customer would be extremely confused by this situation. The broker/dealer had just explained basic investing principles, and provided numerous ideas about how best to invest the non-retirement account. But the customer is not permitted to take these ideas into account in investing the IRA assets. Does that mean that the ideas are not prudent for the IRA assets? Or does it mean that there are some legal issues with making similar investments in an IRA? Or are there additional factors that need to be taken into account in investing IRA assets? Or are the same investments appropriate for the IRA but the broker/dealer is legally prohibited from saying that? Or does the non-retirement advice somehow fall short of a higher standard applicable to IRAs, calling into question the non-retirement advice? The customer will have no idea which is right, and the broker/dealer would be prohibited by the DOL rules from providing any assistance on these questions. Again, this almost inevitable result is not addressed at all in the DRIA. The DRIA simply assumes *without any basis* that everyone can and will use the BICE and that issues like this will not exist.

Information potentially critical to the public's evaluation of the proposal has been unavailable to the commenting public. In a letter to House Education and the Workforce Chairman John Kline (R-MN) and Subcommittee Chairman Phil Roe (R-TN), Secretary Tom Perez stated that:

the Department has consulted extensively with SEC staff on the draft proposal. . . . The SEC staff provided technical assistance on the Department's proposal, including the regulatory impact analysis. The Department has made numerous changes in response to observations and issues raised by SEC staff

Thus, it appears that there were robust discussions between the DOL and the SEC. In light of the fact that the SEC is the primary regulator of the financial services industry, and the proposal relates primarily to the financial services industry, these discussions are of great interest to the commenting public. Yet there is nothing in the DRIA regarding the SEC's views.

Moreover, even more concerning is the fact that DOL has not complied with multiple requests from Members of Congress for documentation regarding the communications between the SEC and the DOL. See the letters to Secretary Perez dated March 4 and March 24, 2015 from Committee Chairman Kline and Subcommittee Chairman Roe. See also the letters to SEC Chair Mary Jo White, dated April 21, May 20, and July 13, 2105, from Senate Homeland Security and Government Affairs Chairman Ron Johnson (R-WI). The last letter from Chairman Johnson states that:

The Labor Department "asked the SEC to defer to the Department's ongoing dialogue with the Committee about the provision of the Department's deliberative materials, and while that dialogue is continuing to defer producing those materials" – indicating that the Labor Department had instructed the Commission *not* to comply with the Committee's request. . . . To be clear, there has been no "ongoing dialogue" with the Committee and the Department about the production of documents.

This is of great concern. The views of the SEC, which has great expertise regarding the regulation of financial services, are very relevant to the notice and comment period regarding the proposal. Yet these views are unavailable to those commenting on the proposal. The unavailability of potentially important information is a serious flaw in the process here, depriving the commenting public of needed information.

None of the above issues received the attention they deserved at OMB. OMB's 50-day review of the proposal was startlingly brief:

- The review period *was almost a month shorter* than the next shortest review period for any significant retirement regulatory proposal in the last 10 years.
- It was less than half the average review period of other significant retirement regulatory proposals in the last 10 years (which was 109 days).
- Equally startling is that the review period after OMB received significant public input was actually just a few days. For example, on April 7, 2015 the Investment Company Institute ("ICI") submitted a very thoughtful eight-page review of the White House's economic analysis of the fiduciary issue, exactly the type of information that OMB is

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mandated to review. ICI met with OMB on April 9, 2015 to discuss the submission.
Only five days later, OMB approved the proposal.

- There is no reasonable explanation for the extremely short review period at OMB, other than a rush to move forward with the regulation in light of the expressed desire to have this rule completed before the next Administration takes over in January of 2017. In light of all the steps needed to get the rule in place before January of 2017, there simply was not time for a meaningful review by OMB.

Thank you for your consideration of the views expressed in this letter.

Sincerely,



Kent A. Mason

APPENDIX**Distinguishing education from advice regarding investment menu assistance:
recommended regulatory language**

Clause (v) of Proposed Regulation § 2510.3-21(b)(6) would be re-designated as clause (vi) and the following new clause (v) would be inserted immediately before such re-designated clause:

“(v) Education Regarding Plan Investment Options.

(A) For purposes of paragraph (b), the services described in this clause (v) are considered to be education and do not constitute advice or recommendations for purposes of paragraph (a).

(B) The following services are described in this clause (v): provision of investment education information and materials to a sponsor of a defined contribution plan in connection with the selection or monitoring of investment options to be offered to plan participants. For this purpose, investment education information and materials shall include: information about general investment concepts and asset classes, the provision of illustrative investment menu models, information on the criteria often used to select a plan investment menu, and information about investment options that satisfy a plan fiduciary’s stated criteria.

(C) The rules of subclause (B) are illustrated by the following examples, all of which are based on the same fact pattern. Small company S discusses with financial institution F the possibility of F providing services with respect to an individual account plan under which participants and beneficiaries can direct the investment of assets in their individual accounts. F maintains a group of 3,000 investment options as its “service provider menu” from which plan sponsors may select some or all such options to offer to their participants under their plan. S desires to offer, as its “plan menu”, 15 investment options to its participants, and seeks education from F regarding how to select the appropriate 15 from the 3,000 options. In all cases, F informs S that (1) F is not functioning as a fiduciary in providing the education, (2) the selection of the plan menu is S’ responsibility, and (3) different investment options can provide different levels of financial benefit to F (and F offers to provide additional information in that regard with respect to any option being considered by S).

(1) Example (1). F discusses with S the factors commonly used by plan sponsors to select plan menus, including fund ratings, past performance (measured against options in the same asset class), risks, fees, and manager tenure. F also discusses with S the different asset classes that are generally offered to participants under a participant-directed individual account plan. S informs F that S wishes to provide its employees with the lowest risk, lowest fee options that are consistent with a suitable plan investment menu. S informs F that fund ratings and past performance are less important, but manager

tenure is of moderate importance. F then provides S with a list of two or three options in each asset class that best meet S' criteria.

Based on the rules of subclause (B), the information provided by F is education, not advice. Screening funds based on S' criteria simply provides S with information on which options would achieve S' objectives.

(2) Example (2). F provides S with several model plan menus that businesses of a similar size with similar risk tolerances have selected. F explains the differences between the model plan menus and why a plan sponsor might choose each one. The information provided by F constitutes education on what similar plan sponsors have selected and why. F is not making recommendations to S, but rather is providing S with the tools to make its own decisions. As such, the information is education, not advice.

(3) Example (3). In responding to a "request for proposal" ("RFP") from S, F provides S with a model plan menu in order to facilitate the provision to S of information on the cost of the plan. F clearly communicates to S that F is not recommending the model plan menu, but is only providing it for pricing purposes.

The information provided by F is education, not advice. The information is conveyed solely to illustrate the cost of the plan, and this is made clear.

(4) Example (4). In helping S select its plan menu, F provides S with economic market analyses and forecasts, such as discussions of the effect of debt issues on the capital markets and reports on the economies of emerging market countries. F also provides S with an analysis of the U.S. political environment and its potential impact on industries and markets. This information is education, not advice: it is not individualized to S' needs, and it does not relate specifically to any fund. It is simply background information that could be used in many different ways to support many different investment decisions.

(5) Example (5). F provides S with objective data that other plan sponsors commonly use in selecting a plan menu, including data regarding fund ratings, past performance (measured against options in the same asset class), risk measurements, fees, and management tenure.

This information simply provides S with tools that are commonly used to make determinations regarding the selection of investment options. The selection of the plan menu is made by S based on the objective information provided. The information provided by F is education, not advice.

(6) Example (6). The same facts as Example (5) except that F also uses the objective data to provide S with two or three options in each asset class typically offered by similar businesses. The screening of funds is not done in a way that is individualized to S' needs.

The information provided by F is education, not advice. Screening funds based on objective data simply provides S with objective information. Another way of looking at this is that F could have simply offered the shorter list to all plan sponsors as its service provider menu, which would have been within the platform exception. That would not have made F a fiduciary. F should be treated

as doing the same thing here; the only difference is that F is doing it in two steps rather than one.

(7) Example (7). F hires an independent third party with expertise in selecting investment options. Using accepted investment evaluation criteria developed independently from F, the third party narrows the service provider menu to a much shorter list from which S can choose a plan menu. For example, the third party could narrow the list to 75 options that meet objective criteria developed by the third party. The third party's criteria are not individualized to S' needs; on the contrary, the same shorter list is provided or available to all prospective plan sponsors of a similar size.

The service provided by F is education, not advice. The service is not individualized to S' needs and does not reflect a recommendation regarding specific options that S should select. The service simply provides S with information regarding how an independent expert would narrow the choices presented to S. Another way of looking at this is that F itself could have simply offered 75 investment options to all plan sponsors as its service provider menu, which would fit within the platform exception. That would not have made F a fiduciary. The fact that the same service is provided by the third party should not make the service fiduciary in nature.

(8) Example (8). S maintains an existing plan and wants to make the transition to using F as its service provider as seamless as possible for its participants. Accordingly, S asks that F create a plan menu through "mapping", i.e., selection of investment options that most closely resemble the existing options offered to plan participants. F creates a plan menu that, based on objective criteria such as Morningstar "fund fact sheets," is similar to the existing plan menu. Where two or more investment options are comparably similar to an existing option, F may provide S with both options.

The information provided by F is education, not advice. Screening funds based on S' criteria simply provides S with information on which options would achieve S' objectives.

(9) Example (9). After a year, S asks F to prepare a report on the plan's menu, including past performance (measured against options in the same asset class), fees, manager tenure, risks, and ratings. F prepares such a report in the manner requested, based on objective criteria or reports of independent third parties.

The information provided by F is education, not advice. F is simply providing information requested by S, based on objective criteria or reports of independent third parties.

(10) Example (10). The same facts as in Example 2, except that S asks F to recommend one of the model plan menus and makes it clear to F that S will follow F's recommendation. F recommends one of the model plan menus. Unless F's recommendation fits within the limitation described in paragraph (b)(1) [**seller's exception**], F's recommendation is advice: (1) the recommendation was individualized to S, and (2) the recommendation was specific regarding the investments for the plan menu.

Critical Review of DOL Regulatory Impact Analysis

Prepared for Davis & Harman

by
Quantria Strategies, LLC

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Davis & Harman, LLP commissioned this report on behalf of a coalition of financial services organizations that provide retirement services to millions of Americans.

Critical Review of DOL Regulatory Impact Analysis

I. Executive Summary

In the DOL Regulatory Impact Analysis for the re-proposed regulations relating to fiduciary investment advice, the DOL estimates that the re-proposed regulations will result in IRA performance *gains of 100 to 200 basis points per year* over the next 20 years, that “*conflicted advice*” costs investors \$210 to \$430 billion over 10 years and \$500 billion to \$1 trillion over 20 years, and that *compliance costs for the industry with respect to the re-proposed regulations will total between \$2.4 and \$5.7 billion* over 10 years.

The DOL acknowledges the imprecision and uncertainty surrounding their estimates. The DOL defines these uncertainties as: (1) the *imprecision in the estimates* of the IRA performance gains, the effects of “conflicted advice,” and the compliance costs; (2) the *potential for the prohibited transaction exemptions to expand exemptions* for current-law fiduciaries; and (3) the *potential for unanticipated and/or unintended negative consequences* of the regulations.

In addition, DOL notes that “some of the performance gap may reflect deliberate and fair payment by IRA investors for observable or intangible services. If so, that portion should not be interpreted as a performance gap associated with conflicts of interest.”¹

However, over the 243 pages of the regulatory analysis, DOL repeatedly and incorrectly implies that (1) all financial advice provided by broker-dealers is conflicted advice, (2) all IRA investors, retirement participants, and small business owners are harmed, when consulting – in any way – with broker-dealers, (3) there are no measurable benefits to using a broker-dealer, and (4) broker-dealers will easily comply with the re-proposed regulations without any significant costs.

A close review of the DOL regulatory impact analysis uncovers many overstatements and flawed assumptions. DOL cites numerous studies that they argue support the re-proposed regulation, yet closer scrutiny shows that many of the studies either are not relevant or caveat the findings on which DOL relies. When subjected to close scrutiny, the DOL analysis fails to support the re-proposed regulation on many levels, including the following:

1. *DOL fails to incorporate any estimates of the positive benefits of financial advice*, even though the DOL admits that there may be “observable or intangible” benefits to using a broker-dealer and despite the fact that *DOL previously estimated that retirement plan participants made investment mistakes of approximately \$114 billion in 2010 due in large part to the lack of financial advice. Including estimates of the positive effects of financial advice would (1) reduce the estimates of the losses attributable to so-called “conflicted advice” under current law, and (2) increase the costs to IRA owners and retirement plan participants under the re-proposed regulation.*

¹ United States Department of Labor, Fiduciary Investment Advice, Regulatory Impact Analysis, section 8.1.1., IRA Performance Gap, p. 212.

In its own regulatory analysis for the re-proposed regulation, *DOL states that some of the studies “find robust evidence that advice affects savings styles and levels. . .at least some of the advised investors’ excess fees. . .can be interpreted as fair payment for financial services that yield consumer benefits other than improved investment performance.”*²

2. *DOL claims that front-end load mutual funds “underperform” by 100-200 basis points per year, but the academic research DOL cites and additional data analysis show that these claims cannot be supported.*

The Investment Company Institute (ICI) examined market data *from 2007 to 2013* and found that the *sales-weighted average returns for shares sold with front-end loads actually did better than an industry average by 27 basis points, directly countering DOL estimates of 100-200 basis points of underperformance.* ICI also found that the *DOL ignored the costs of fee-based accounts, overstating the cost difference between front-end load accounts and fee-based accounts.*

According to ICI, *“the DOL does not actually measure – and cannot measure, based on these studies – whether an investor using a fee-based ERISA fiduciary adviser will experience a different outcome than an investor using another financial adviser that is not an ERISA fiduciary.”*

3. The *DOL regulatory impact analysis cites numerous supporting studies that, upon closer scrutiny, often qualify their findings with caveats concerning the findings and suggestions for further research.*

Often, the evidence cited by DOL represents a “potential,” rather than an “actual,” conflict of interest. *DOL assumes that the mere existence of certain characteristics – for example, the receipt of commissions – leads to improper behavior* and that most, if not all, RIAs acted improperly with respect to their clients.

The DOL analysis argues that individuals with low financial literacy can be manipulated by financial advisers. But *lack of financial literacy offers a reason why investors need access to financial advice. Investors who lack financial literacy tend to start saving later, save less than they should, and don’t retain their savings for retirement purposes.* For example, *one study* cited by DOL (Hung et al (2010)) *found that having employers offer financial advice to employees can result in improved financial outcomes.*

DOL states that additional disclosure will not be effective because IRA investors cannot understand potential conflicts of interest. *Yet the re-proposed regulations require disclosures that provide so much information that the average individual could not possibly assess all the information.*

² United States Department of Labor, Fiduciary Investment Advice, Regulatory Impact Analysis, section 3.2.3.5 Eroded IRA Returns, p. 94.

4. DOL's *compliance cost estimates likely significantly underestimate the actual costs* and fail to account for the fact that these costs will be borne by consumers.

For example, DOL significantly underestimated the costs of updating computer systems to comply with the best interest contract exemption. DOL estimated 280,000 hours of burden during the first year and approximately 22,000 hours of burden in subsequent years at a cost of \$22.3 million and \$1.8 million respectively. However, two companies reported significantly higher costs to comply with disclosure rules under another regulation that required significantly less information than required under the best interest contract exemption. One company reported more than 100,000 IT hours at a cost of approximately \$8.4 million and another company reported spending more than 90,000 hours at a cost of over \$6.5 million. These examples suggest that *the IT costs (a small component of DOL's overall costs of compliance) could be significantly underestimated, raising questions about the assumptions underlying the other components of DOL's costs of compliance. Note that the combined effect of these two companies (\$14.9 million) totals 67 percent of the DOL's total estimate of IT costs (\$22.3 million) for the first year under the regulatory analysis.*

5. DOL assumes that *financial advisers will accept reduced fees without any change in either the quantity or quality of their investment advice*, but basic economic analysis suggests that this assumption cannot be supported.

Basic economic principles suggest that, if an adviser's costs increase as a result of the re-proposed regulation, these costs will be borne by the adviser's customers either through decreased services or increased costs to the customer. The decreased services would involve either the exit of certain advisers from the market or a reduction in the intensity of advice provided by remaining advisers.

DOL notes the potential for reduced access to financial advice and states "*the Department takes seriously the risk that banning adviser conflicts could reduce access to advice for some IRA investors, and that not only their investing but also their saving might suffer as a result. Even if the potential for this result is limited, its severity is sufficiently great that the Department agrees caution is required.*"³

DOL dismisses virtually all of the information and data provided by the industry on the potential impact of the regulations even though this information could help inform the DOL estimates. Although the industry has consistently indicated its support for a fiduciary standard implemented by the appropriate regulatory authorities and has offered to work closely with DOL to develop workable rules, the DOL regulatory analysis reads more like a legal brief in litigation than a reasoned analysis supporting the re-proposed regulations.

DOL provided an extremely short period for review and comment with respect to the re-proposed regulations and an extraordinarily short period after finalization before the regulations become effective. These time periods suggest that DOL may implement the regulations without taking into account input from the industry that must comply with the rules.

³ DOL Regulatory Analysis, section 3.2.2., Qualitative Discussion, p. 109.

Taken together, the flaws with the DOL regulatory analysis raise significant questions about the justification for the re-proposed regulations. As detailed below, each of these points raises questions about whether DOL's regulatory analysis supports the broad conclusions that are drawn.

II. Failure to Account for Positive Benefits of Financial Advice

DOL fails to incorporate any estimates of the positive benefits of financial advice, even though the DOL admits that there may be “observable or intangible” benefits to using a broker-dealer and despite the fact that DOL previously estimated that retirement plan participants made investment mistakes of approximately \$114 billion in 2010 due in large part to the lack of financial advice. Including estimates of the positive effects of financial advice would (1) reduce the estimates of the losses attributable to so-called “conflicted advice” under current law, and (2) increase the costs to IRA owners and retirement plan participants under the re-proposed regulations.

The DOL regulatory analysis acknowledges that there may be positive benefits to individuals who have access to financial assistance, but fails to measure these benefits. DOL states “some of the performance gap may reflect deliberate and fair payment by IRA investors for observable or intangible services. If so, that portion should not be interpreted as a performance gap associated with conflicts in advice.”⁴ By ignoring the positive benefits of financial advice under current practices, DOL overstates estimates of the losses theoretically occurring with what DOL calls “conflicted advice.” In addition, DOL fails to account for the losses of these positive benefits that occur to the extent that the re-proposed regulations result in less access to financial advice.

The potential benefits of financial advice include, at the participant level, (1) the decision to begin saving for retirement, (2) increasing the amount saved for retirement, (3) making sensible portfolio choices, and (4) retaining retirement benefits in a qualified retirement savings arrangement (qualified plan or IRA) on a potential distribution event, such as job change.

In addition, financial assistance increases the number of retirement plans established by small employers and the number of IRAs established by individuals and small businesses. Some research refers to these as the “intangible” benefits of receiving financial assistance. However, the reality is that these benefits are quite “tangible.” While it may be difficult to measure how financial assistance affects any specific individual's decisions, research shows that individuals who have access to financial assistance have larger account balances, all things (including income and age) being equal. Yet, DOL does not acknowledge or attempt to measure the positive effects of financial assistance that supports these larger account balances.

⁴ DOL Regulatory Impact Analysis, section 8.1.1, IRA Performance Gap, p. 212.

A. DOL Estimates of Errors Attributable to Lack of Financial Advice

DOL ignored its own estimates of the benefits of financial advice in the regulatory analysis. In a 2011 regulatory impact analysis to a final regulation relating to a new prohibited transaction exemption for the fiduciary standard rules, DOL stated the following:

“The results of this final regulation will depend on its impacts on the availability, cost, use, and quality of participant investment advice. The Department anticipates that, as a result of these actions, quality, affordable expert investment advice will proliferate, producing significant net gains for participant-directed defined contribution (DC) plan participants and beneficiaries and beneficiaries of individual retirement accounts (IRAs). The improved investment results will reflect reductions in investment errors such as poor trading strategies and inadequate diversification.”⁵

DOL further states “there is evidence that many participants of these retirement accounts often make costly investment errors due to flawed information or reasoning . . . Financial losses (including foregone earnings) from such mistakes likely amounted to more than \$114 billion in 2010. These losses compound and grow larger as workers progress toward and into retirement.”⁶ In fact, as justification for the rule, ***DOL states that individuals who do not receive financial advice with respect to their retirement savings are twice as likely to make a mistake as those who do receive financial advice.***⁷ DOL notes that these mistakes and losses can be attributed to the loss of access to financial advice under ERISA and the prohibited transaction provisions. Specifically in reference to the prohibited transaction provisions, DOL states:

“Such mistakes and consequent losses historically can be attributed at least in part to provisions in the Employee Retirement Income Security Act of 1974 that effectively preclude a variety of arrangements whereby financial professionals might otherwise provide retirement plan participants with expert investment advice.”⁸

By finalizing the prohibited transaction exemption regulation that allowed more IRA owners and retirement plan participants to receive financial advice, DOL estimated the benefits of this advice as follows:

“The Department believes that this final regulation will provide important benefits to society by extending quality, expert investment advice to more participants, leading them to make fewer investment mistakes. . . participants, after having received such advice, may pay lower fees and expenses, engage in less excessive or poorly timed trading, more adequately diversify their portfolios, and thereby

⁵ U.S. Department of Labor, Employee Benefits Security Administration, 29 CFR Part 2550, Investment Advice – Participants and Beneficiaries, D. Regulatory Impact Analysis, Federal Register, Vol. 76 No. 206, Tuesday, October 25, 2011, p. 66151.

⁶ *Ibid.* at p. 66151.

⁷ *Ibid.* at p. 66153.

⁸ *Ibid.* at p. 66151.

assume less uncompensated risk, achieve a more optimal level of compensated risk, and/or pay less excess taxes.”⁹

B. Research on Benefits of Financial Advice

Ample evidence of the benefits of access to financial advice exists with respect to IRA owners and retirement plan participants, yet DOL ignored or dismissed this evidence in its regulatory analysis. In fact, the DOL regulatory analysis for the re-proposed regulations acknowledges these benefits, stating with respect to some of the studies used in the DOL analysis:

“However, they also find *robust evidence that advice affects savings styles and levels, and suggest that the higher fees paid by advised clients might reflect payment for broader financial advice.* Both the industry-generated investor survey results and Foerster et al.’s finding of savings impacts suggest that at least some of advised investors’ excess fees. . . can be interpreted as fair payment for financial services that yield consumer benefits other than improved investment performance.”¹⁰

DOL goes on to state “that is not to say that benefits such as savings goals, estate planning, and time saving can be completely ruled out as factors contributing to returns differences.”¹¹ Even after acknowledging the potential benefits of financial advice, DOL failed to measure them, even though they had previously estimated these benefits in the 2011 regulatory analysis.

Other studies provide additional support for the notion that there are measurable benefits of financial advice that should be taken into account when assessing the costs of the re-proposed regulation. A recent report commissioned by the DOL specifically addresses the benefit of financial advice with respect to unsophisticated (e.g., financially illiterate) investors. Garber et al. (2015) discuss the potential economic effects on individual retirement markets and investors of the 2010 DOL proposed regulation.¹² This analysis applies to the re-proposed regulations as well. Garber et al. state that, without the proposed regulation, “*unsophisticated investors benefit from time savings*” by using a financial adviser and “*also benefit from help in choosing investment products (relative to those making these choices without professional help) and from coaching to open IRAs, contribute appropriate amounts, and so on.*”¹³

Garber et al. further state that a key question concerning the proposed regulation relates to how the rule would affect the well-being or welfare of investors. They note that adopting the rule would likely help some investors and hurt others; they conclude by stating “we cannot predict

⁹ *Ibid.* at p. 66152.

¹⁰ U.S. Department of Labor, Fiduciary Investment Advice, Regulatory Analysis, Section 3.2.3.5, Eroded IRA Returns, p. 94, April 14, 2015.

¹¹ *Ibid.* at p. 94.

¹² Garber, Steven, Jeremy Burke, Angela Hung, and Eric Talley. *Potential Economic Effects on Individual Retirement Account Markets and Investors of DOL’s Proposed Rule Concerning the Definition of a ‘Fiduciary.’* Rand Corporation, Rand Labor and Population, RR-1009-DOL, February 2015, prepared for the Department of Labor.

¹³ *Ibid.* at 23.

whether the benefits to IRA investors would outweigh their costs for any particular type of IRA investor or in the aggregate.”¹⁴

A 2014 Financial Engines/AOL Hewitt study attempts to quantify the benefits of the use of “help” in defined contribution plans.¹⁵ The Financial Engines/AON Hewitt study provides important information with respect to participants who do not receive any form of help finding that 60.5 percent of non-help participants had inappropriate levels of risk (either too high or too low) and lower returns (332 basis points lower, net of fees). The study also found that near retirees needed the most help with this group having the widest variability in risk levels.

C. Quantifying the Benefits of Financial Advice

The fact that the 2011 DOL analysis quantified the benefits of financial advice suggests that the benefits of financial advice can and should also be taken into account with respect to the re-proposed regulations. Indeed, their own analysis of the 2011 regulations provides support for recognizing the benefits of financial advice in the regulatory impact analysis for the re-proposed regulation.

Incorporated in the 2011 estimates were assumptions concerning the availability and use of advice by defined contribution (DC) plan participants and IRA owners. DOL assumed that 63 percent of DC plans offered some form of advice (online or live) and that 16 percent of DC plan participants utilized advice (25 percent of DC plan participants utilized advice when it was offered).¹⁶ DOL also assumed that 67 percent of IRA owners utilized financial advice. These estimates appear consistent with DOL’s estimates for the re-proposed regulation that ignore the benefits of financial advice.¹⁷

A recent study by the Center for a Secure Retirement quantified the benefits of access to financial advice. The study found that, *among similarly situated individuals* (middle-income Baby Boomers, defined as those with annual household income between \$25,000 and \$100,000), *individuals who work with a financial professional were more likely (25 percent) to have investable assets over \$500,000 than those who do not work with a financial professional (less than 10 percent)*.¹⁸ In other words, an individual who worked with a financial professional was 2.5 times more likely to have investable assets over \$500,000.

The Secure Retirement study found that the length of time an individual has worked with a financial professional also contributed to higher asset levels. Among those who worked with a financial professional for less than two years, 43 percent reported assets less than \$100,000, 38 percent reported assets between \$100,000 and \$500,000, and 19 percent reported assets

¹⁴ *Ibid.* at 26.

¹⁵ Financial Engines, AON Hewitt, *Help in Defined Contribution Plans: 2006 through 2012*, May 2014.

¹⁶ 2011 Regulation, *supra*.

¹⁷ Using these statistics and other research on the value of financial advice, DOL was able to estimate the losses to retirement savings when DC plan participants and IRA owners do not have access to financial advice.

¹⁸ Center for a Secure Retirement, *The Middle-Income Boomer Retirement Gap: Savings, Education, and Advice*, November 2014.

exceeding \$500,000. On the other hand, for individuals who had worked with a financial professional for at least 10 years, 24 percent reported assets less than \$100,000, 47 percent reported assets between \$100,000 and \$500,000, and 28 percent reported assets exceeding \$500,000.

A *DOL-sponsored pilot survey* (that examined how DC plan participants make retirement decisions) ***supports empirical research indicating that retirement savings plan balances are 33 percent higher if a participant receives financial advice.***¹⁹ These results occurred consistently across all demographic groups, implying significant positive benefits attributable to access to financial advice.

Anecdotal evidence provided by financial services companies also supports the idea that there are measurable positive benefits to financial advice that should be measured. One company indicated that oral communications with employees terminating employment have a significant effect on cash-out rates; employees with account balances between \$35,000 and \$50,000 are approximately 3.2 times less likely to cash out their retirement savings if they receive a call rather than only receiving written communications.

As noted above, the 2011 DOL regulatory analysis concluded participants who select their own investments often choose inappropriate levels of risk (either too low or too high). In addition to encouraging individuals to begin saving for retirement and to save appropriate amounts, financial advisers help individuals select appropriate levels of risk for their retirement savings investments (consistent with the individual's comfort level). DOL's focus on rates of returns is misleading, because it fails to account for individual preferences for lower risk levels (and often lower rates of return associated with lower risk investments, e.g. government securities). In addition, the DOL focus neglects to account for the ancillary benefits of using a financial adviser, including risk management.

¹⁹ Rand American Life Panel, Well-Being Survey 189. The survey asked the following question: "How do you make decisions about savings and investment related to retirement?" The possible responses were: "1) Ask relatives/friends, 2) Talk to financial planners/brokers, 3) Talk to lawyers, 4) Read magazines/newspapers/books, 5) Get advice from television, and 6) Other." Of the respondents who had not already retired, approximately 24 percent indicated that they had talked to financial planners/brokers. These contacts likely include both consultation with a paid financial planner and contacts through a call center or broker-dealer associated with their employer's retirement savings plan.

III. DOL Claims of Front-End Load Fund Underperformance Inconsistent With Market Data

DOL claims that front-end load mutual funds “underperform” by 100-200 basis points per year resulting in costs to IRA mutual fund investors of \$430 billion over 10 years and nearly \$1 trillion over 20 years, but the academic research DOL cites and additional data analysis show that these claims cannot be supported.

A. ICI Estimates of Front-Load Mutual Fund Performance

Recent research by the Investment Company Institute suggests that DOL’s estimates of underperformance by front-end load mutual funds used to justify the approach taken in the re-proposed regulation cannot be supported.²⁰ The ICI states

“The DOL has arrived at these numbers (DOL’s estimates of underperformance) by misinterpreting and incorrectly applying the findings of academic research that it cites as the foundation of its conclusions. In fact, these assertions do not stand up when tested against actual experience and data.”²¹

ICI examined front-load mutual fund shares sold from 2007 to 2013 and measured fund returns net of expenses in the year after the sale. ICI found that the sales-weighted average returns for shares sold with front-end loads actually did better than an industry average calculated from Morningstar performance data by 27 basis points, directly countering DOL estimates of 100-200 basis points of underperformance. ICI notes that *DOL failed to test its estimates against “real and widely available” market data* and states *“the fact that investors concentrated their purchases of fund shares sold with a front-end load in those funds that outperformed the average return for their category undermines the DOL’s analysis and eliminates almost all of the rationale the DOL uses to justify its proposal.”²²*

Further, the ICI analysis notes that none of the studies cited by DOL to support its conclusion of rampant so-called “conflicted advice” actually examine the outcomes of investing with a financial adviser who is a fiduciary compared to a financial adviser who is not a fiduciary. Thus, according to ICI, *“the DOL does not actually measure – and cannot measure, based on these studies – whether an investor using a fee-based ERISA fiduciary adviser will experience a different outcome than an investor using another financial adviser that is not an ERISA fiduciary.”²³*

²⁰ See *Statement of the Investment Company Institute, Brian Reid, Chief Economist, Hearing on “Restricting Access to Financial Advice: Evaluating the Costs and Consequences for Working Families and Retirees,”* before the Subcommittee on Health, Employment, Labor, and Pensions, Committee on Education and the Workforce, United States House of Representatives, June 17, 2015.

²¹ *Ibid.* at p. 2.

²² *Ibid.* at p. 4.

²³ *Ibid.* at p. 5.

ICI also notes that the DOL analysis treats front-end loads as a cost, but ignores the costs of fee-based accounts, thereby overstating the cost differences between these types of accounts. Specifically, ICI states

“The DOL’s analysis is flawed in another fundamental way: it ignores the cost of advice and services outside of broker-sold accounts, resulting in an inappropriate overstatement of the benefits of the proposal. The DOL focuses solely on the costs of advice and assistance paid through a fund—through an up-front sales charge, for example. But the DOL fails to consider how these costs compare to the costs that investors incur when they pay a financial advisor directly for advice (for example using an asset-based fee that an investor pays directly to a financial advisor) rather than paying through a load. Ignoring the market realities of the cost of advice and assistance, the DOL exaggerates the benefits from lower loads resulting from their proposal and ignores possible costs that investors could incur if they move to fee-based accounts.

How significant is this omission? The DOL argues that IRA investors currently pay between 26 and 28 basis points per year in front-end loads, in addition to fund expenses. A recent study by Cerulli Associates finds that fee-based accounts – the most likely alternative to brokerage accounts – cost investors 111 basis points per year on average, in addition to fund expenses.”²⁴

B. DOL Cited Research

DOL cites research that they say supports the view that investors are pushed into “questionable investments” based on the potential fees that brokers and others might earn on the investments. They argue that the research uniformly finds that investors put more money into funds that attract higher payments to brokers and state that this supports the view that brokers and financial advisers “apparently serve their own interest by guiding investors into funds with higher loads.”²⁵

DOL relies significantly on the findings in Bergstresser et al. (2009) as support for the conclusion that broker-dealers provide “conflicted” advice to IRA and retirement plan participants. The research examined risk-related returns between “direct sold” and “broker-sold” mutual funds over the 1996 to 2004 period, finding that broker-sold mutual funds delivered lower risk-adjusted returns, except with respect to foreign equity funds.²⁶ Thus, the research examines mutual funds in general and does not specifically examine the effects of broker assistance on IRA or retirement savings plan participants. DOL extrapolates the results of the research to IRA and retirement savings plan investments, but does not consider whether the evidence supports such extrapolation.

²⁴ *Ibid.* at p. 4.

²⁵ DOL Regulatory Analysis, 3.2.3.4.2, p. 87.

²⁶ Bergstresser et al. describe direct-sold funds are marketed by the fund directly to the consumer, while broker-sold funds are sold by an intermediary.

Bergstresser et al. examine the demographics of mutual fund investors and find these individuals to be disproportionately drawn from upper ranks of national wealth, income, and educational attainment. DOL does not explore whether the demographics of mutual fund investors in the Bergstresser research would compare to the demographics of individuals participating in IRAs or a qualified retirement savings plan, but rather presumes that the Bergstresser research applies to IRAs and qualified retirement plan participants without considering or adjusting for the different demographic characteristics of these participants compared to mutual fund buyers.

The DOL analysis neglected to mention that Bergstresser et al. indicate that their results do not account for the potential intangible (and tangible) benefits of brokers, including that “*brokers may help their clients save more than they would otherwise save, they may help clients more efficiently use their scarce time, and they may increase overall investor comfort with their investment decisions.*”²⁷

Other papers cited by DOL to support the estimates of the magnitude of underperformance caused by “conflicted advice” also relate to purchases in the retail mutual fund market and not specifically to IRAs (e.g., Del Guercio and Reuter (2014)).²⁸ Del Guercio and Reuter found that actively-managed funds sold directly to investors outperformed index funds and broker sold index funds outperform broker sold actively-managed funds, but did not examine whether these returns would differ if investors used a fiduciary adviser.

Further, the February 2015 Council of Economic Advisors (CEA) analysis of this issue noted limitations in the Bergstresser and Del Guercio papers. CEA notes

“One limitation of this type of comparison is that it may incorporate differences other than the presence of conflicted advice between the types of investors purchasing funds through these two sources. For instance, investors purchasing funds through intermediaries may be more risk-averse and less experienced with investing than those buying direct-sold shares from a mutual fund sponsor. Failing to account for such differences may potentially overstate or understate losses due to conflicts of interest.”²⁹

Only one paper, Chalmers and Reuter (2014), examines an employer retirement plan. Chalmers and Reuter finds that broker clients in the Oregon State University’s defined contribution retirement plan underperformed self-directed investors by 1.54 percentage points.³⁰ However, Chalmers and Reuter note that the investment menus in the options being examined were significantly different. As a result, it is not clear whether the results reported in the study relate specifically to the effects of broker-dealer advice. Further, the study did not examine whether

²⁷ Bergstresser et al. 2009, at 4131.

²⁸ DOL Regulatory Analysis, section 3.2.4., Magnitude of Harm, p. 95-96.

²⁹ Executive Office of the President of the United States of America, *The Effects of Conflicted Investment Advice on Retirement Savings*, February 2015, at p. 11.

³⁰ Chalmers, John and Jonathan Reuter, *What is the Impact of Financial Advisors on Retirement Portfolio Choices and Outcomes?*, University of Oregon and Boston College, 2014.

the results would have been different if individuals in the plan had access to financial advice provided by a fiduciary.

One notable additional point worth mentioning concerning the Chalmers and Reuter paper relates to the characteristics of the plan. The contribution amount to the Oregon State University plan was a fixed percentage of salary paid by the employer on behalf of all participating employees. Thus, as noted in the paper, “there is no scope for brokers to increase savings rates within ORP.”³¹ As a result, the structure of the plan prevented Chalmers and Reuter from examining the potential positive effects that financial advice might have had on savings behavior. Thus, the results in the paper fail to examine all of the effects that might accrue from access to financial advice.

C. Long-Term Trends in Mutual Fund Fees

Research and analysis of ICI data contradict DOL’s arguments concerning the harm caused by brokerage relationships. First, declines in the expense ratios of mutual funds, including actively-managed funds, suggest that competition in the marketplace may be driving down the fees that investors pay. Second, this competition would not occur if investors did not demand lower fees. Finally, low cost index funds may have costs that are not reflected in the fund’s expense ratio, i.e., direct payments to an adviser under a fee-based arrangement, so a comparison of fees between actively-managed funds and index funds may not capture the full extent of index fund costs.

Long-term trends show significant declines in mutual fund expense ratios, which include portfolio management costs, fund administration and compliance costs, shareholder service expenses, recordkeeping, certain kinds of distribution charges (e.g., 12b-1 fees), and other operating costs.³²

Table 1 shows the average expense ratios for mutual funds from 2000-2013.

³¹ Chalmers and Reuter, p. 8.

³² See, Investment Company Institute, *2015 Investment Company Fact Book, A Review of Trends and Activities in the U.S. Investment Company Industry, 55th Edition, 2015.*

Year	Equity	Hybrid	Bond	Money Market
2014	70	78	57	13
2013	74	80	61	17
2012	77	79	61	18
2011	79	80	62	21
2010	83	82	63	24
2009	87	84	64	33
2008	83	77	61	35
2007	86	77	64	38
2006	88	78	67	40
2005	91	81	68	42
2004	95	85	72	42
2003	100	90	75	42
2002	100	89	74	44
2001	99	89	75	46
2000	99	89	76	49

Source: Investment Company Institute, *2015 Investment Company Fact Book, 55th Edition, 2013.*

For equity funds, over the 14 year 2000-2014 period, the average expense ratio declined from 99 basis points to 70 basis points, a decline of 29 percent, while the average for hybrid funds declined by 12 percent, for bond funds declined by 25 percent, and for money market funds declined by 73 percent. The ICI attributes the decline in average expense ratios for equity and long-term funds to a shift of investors toward no-load share classes, which is due in large part to changes in the way that investors compensate brokers and other financial professionals.³³

Over the last 30 years, there has been a shift away from front-end load fees (a one-time, up-front payment for current and future services) to asset-based fees (fees assessed as a percentage of the assets that a financial manages for an investor). ICI notes that, from 2005 to 2014, front-end and back-end load share classes have seen \$717 billion in outflows, while the greatest inflow of funds occurred in no-load share classes.

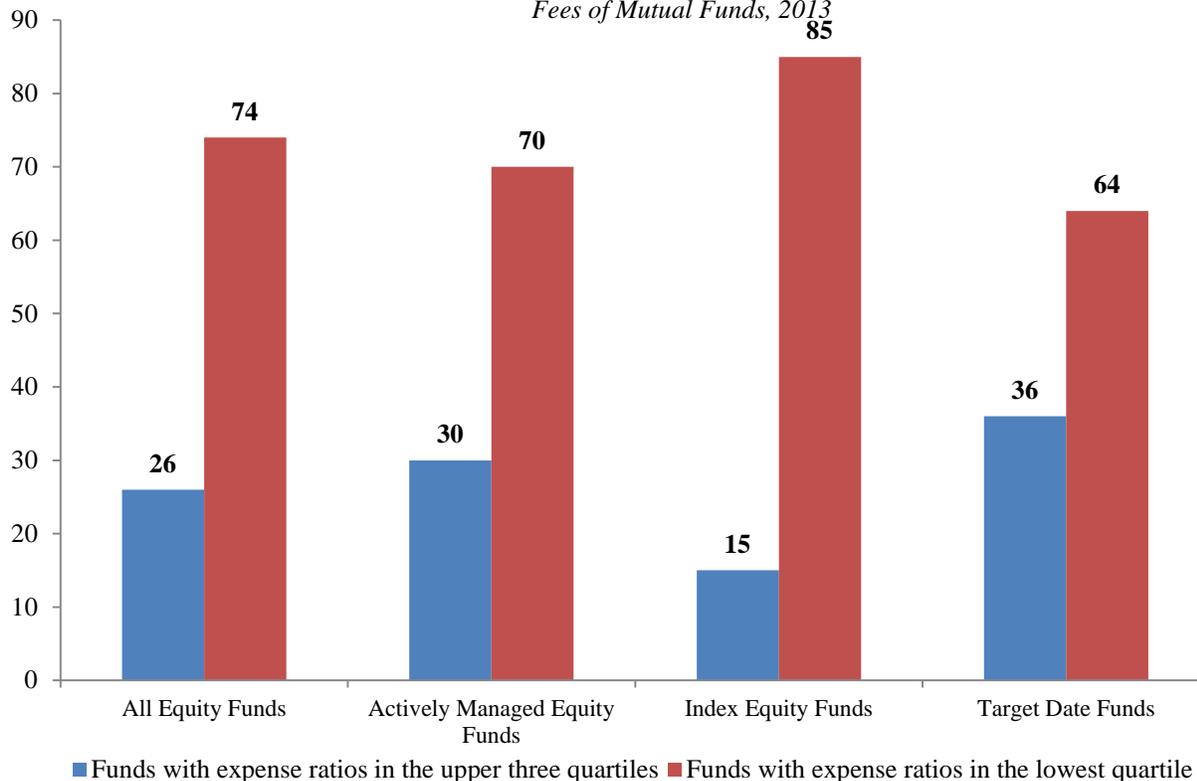
At the same time, the average expense ratios for actively-managed funds, which would likely have higher fees because of the more intensive analysis required by financial advisers and brokers, have also declined.

ICI finds that the average expense ratios for both actively-managed funds and for index funds, which tend to have lower expense ratios, have declined by approximately the same amounts with a 20 basis point decline for actively-managed funds and a 16 basis point decline for index funds over the 2000 to 2014 period. Part of this decline can be attributed to an increase in the percentage of assets invested in lower-cost funds, a trend that applies both to actively-managed and index funds.

³³ *Ibid.*

Graph 1.--Concentration of Assets in Lower-Cost Mutual Funds, 2013
(Percentage of Total Assets)

Source: Investment Company Institute, *Trends in the Expenses and Fees of Mutual Funds, 2013*



According to ICI data, in 2000, 33 percent of the assets in actively-managed funds were invested in the funds with expense ratios in the lowest decile; by 2013, this percentage had increased to 49 percent of the assets in actively-managed funds.³⁴ In 2014, among actively-managed equity funds, index equity funds, and target date funds, assets tend to be concentrated in lower-cost funds (see Graph 1).

Further, as the ICI hearing testimony discussed previously points out, the correct comparison is between (1) fee-based accounts that may invest in index funds at a cost of 11 basis points plus the adviser’s fees of 111 basis points for total of 122 basis points, and (2) 86 basis points for brokerage accounts, showing that, on average, investors save 36 basis points under the broker-dealer model.³⁵

³⁴ *Trends in the Expenses and Fees of Mutual Funds, 2013*. Investment Company Institute, ICI Research Perspective, Vol. 20, No. 2, May 2014.

³⁵ *Statement of the Investment Company Institute, supra.*

D. Reliance on Foreign Experience

DOL cites papers that purport to measure the effects of “conflicted advice,” but the papers cite data relating to foreign investment markets, not U.S. investment markets. Specifically, Foerster et al. (2014) and Hackethal et al. (2012) relate to investors in Canada and Germany, respectively.

There is no evidence that either Canada or Germany presents the same statutory, regulatory, or investor behavioral framework as the United States. Therefore, conclusions about the effects of the re-proposed regulations cannot be inferred from these studies.

IV. DOL Ignores Qualifying Statements Made in Research Relied on to Support DOL Arguments

The DOL regulatory impact analysis cites numerous studies in support of their positions. But closer scrutiny reveals that these studies often qualify their findings with caveats concerning the findings and suggestions for further research.

A. Existence of Conflicts

DOL identifies what it calls “conflicts of interest” in the case of broker-dealer interactions with IRA customers. However, often the evidence cited by DOL represents a “potential,” rather than an “actual,” conflict of interest. For example, DOL cites a RAND study for the Securities and Exchange Commission (SEC), as evidence that registered investment advisors (RIAs) are “often highly conflicted.”³⁶ However, the statistics cited by DOL do not represent evidence that RIAs consistently acted in a way that was against their clients’ best interests. Rather, DOL assumes that the mere existence of certain characteristics – for example, the receipt of commissions – leads to improper behavior and that most, if not all, RIAs acted improperly with respect to their clients. Further, the Rand study states “the current body of literature generally cannot account for selection issues and the intangible benefits financial advisers provide.”³⁷

Similarly, DOL cites research relating to concerns with contingent commissions of insurance agents, but then notes that “it is unclear whether or to what degree contingent commissions might affect IRA investors.”³⁸

DOL cites the empirical model created by Stoughton, Wu, and Zechner (2011) as support for the position that investors who use a financial adviser who receives a fee rebate or kickback are not only worse off than they were without the conflict of interest, but they are “worse off than they would have been if the investment adviser did not exist at all.”³⁹ However, once again, the

³⁶ DOL regulatory analysis, section 3.2.3.1, p. 73.

³⁷ Burke, Jeremy, Angela A. Hung, Jack W. Clift, Steven Garber, and Joanne K. Yoong. *Impacts of Conflicts of Interest in the Financial Services Industry*. Rand Corporation, Rand Labor & Population, Working Paper WR-1076, August 2014, p. 2. The work in the report was supported by a grant funded by the Department of Labor.

³⁸ *Ibid.* p. 74.

³⁹ *Ibid.* p. 75.

research contains important caveats that DOL does not mention. In their conclusions, these authors state the following:

“Advisory services provide an opportunity for smaller investors to participate in an actively managed portfolio, consisting for instance of alternative investments which would not be economical without the use of an adviser. . .the presence of advisers improves the total welfare of the portfolio manager and investors *even when they are subject to potential conflicts of interest* (emphasis added).”⁴⁰

The authors go on to state that, while it is tempting to conclude from their research that rebates should be banned, this conclusion should not be drawn.

B. Costly Pursuit of Customers

DOL argues that IRA customers bear the costs of advertising, marketing, and other expenses intended to secure new customers and that this results in costs that are “unlikely to yield commensurate benefits for IRA customers.”⁴¹ However, the fact that customers bear the costs of marketing and other business expenses represents a fundamental principle of business economics. In fact, most of the section of the DOL regulatory analysis deals less with advertising and more with DOL’s objection to the fees received by advisers.

C. Obstacles to Assessing Advice Quality

The DOL states “almost certainly, the great majority of IRA investors cannot directly assess the quality of the investment advice they receive.”⁴² The DOL cites research relating to basic issues of financial literacy to support this statement and notes “older Americans ‘lack even a rudimentary understanding of stock and bond prices, risk diversification, portfolio choice, and investment fees.’”⁴³ Yet, *the problems with financial illiteracy also point to a more fundamental problem – without access to some sort of financial advice or assistance, individuals tend to make suboptimal decisions concerning their retirement savings. The DOL completely ignores this issue*, as addressed in section B., above.

DOL cites research that they contend supports their view that individuals are unable to assess the quality of financial advice that they receive. However, the research also contains important caveats. For example, DOL cites the problems with financial adviser advice in a study by Mullainathan, Noeth, and Schoar (2012), but the researchers also qualify their results by noting that their research was a first step that did not take into account important issues that should be considered. In addition, the authors concluded “it is possible that fee-only advisers provide

⁴⁰ Stoughton, Neal M., Youchang Wu, and Josef Zechner. *Intermediated Investment Management*. Journal of Finance 66, no. 3 (2011), p. 35.

⁴¹ DOL regulatory analysis, section 3.2.3.2, p. 75.

⁴² DOL regulatory analysis, section 3.2.3.3.1, p. 77.

⁴³ DOL regulatory analysis, section 3.2.3.3.1, p. 77-78, citing Lusardi Annamaria, Olivia Mitchell, and Vilsa Curto, *Financial Literacy and Financial Sophistication among Older Americans*, NBER Working Paper 15469, 2009.

better advice but have to charge such high fees that average retail investors are better off in the status quo situation.”⁴⁴

In addition, researchers have noted that the results of the academic research have been mixed. For example, a paper by Bluethgen, Meyer, and Hackethal (2008), which DOL cites as supporting their position, found that investors who received advice had higher quality, more diversified portfolios, and also paid higher fees on their investments. But the authors posited that these fees may have provided compensation to the adviser for the benefits of improved investment efficiency. Kramer (2012) found that advised accounts were better diversified than self-directed accounts.

Further, the DOL analysis discusses at length the problem of financial literacy among average investors. ***But lack of financial literacy also offers a reason why investors need access to financial advice and assistance. Because investors lack the knowledge to make sound decisions about saving for retirement, they tend to start saving later, save less than they should, and don't keep their savings for retirement purposes.***

Hung et al. (2010) found that individuals with low financial literacy are more likely to seek advice when it is offered to them. Further, the research suggests that having employers offer financial advice to employees and ensuring employees engage in active decision making can result in significant utilization of the financial advice and improved financial outcomes. The research concluded that moving from knowledge to actual behavior changes required both advice and educational materials designed to engage rather than inform individuals. Thus, this research suggests that active efforts to improve financial literacy and provide financial advice will improve retirement savings outcomes.

D. Lack of Reputation Effects

Along the same lines, DOL argues that individuals cannot assess the value of financial advisers (reputation effects) because they are unable to process the information necessary to judge whether financial advisers are giving them good or bad advice. DOL cites research suggesting that reputation effects will cause investors to reject advisers who provide bad advice, but then DOL rejects the research by saying that IRA investors don't have the attention and understanding of adviser performance to make accurate assessments of their adviser.

Inderst and Ottaviani, cited in the DOL analysis, have conducted extensive research on financial advice. DOL cites this research, but concludes that few IRA investors would qualify as wary consumers in the Inderst and Ottaviani model.

DOL does not discuss the fact that Inderst and Ottaviani also point out some of the potential downsides of increased regulation of financial advice. Their 2011 paper states “policy intervention that mandates disclosure of commissions can protect naïve consumers and increase welfare. However, ***prohibiting or capping commissions could have the unintended***

⁴⁴ Mullainathan, Sendhil, Markus Noeth, and Antoinette Schoar, *The Market for Financial Advice: An Audit Study*, National Bureau of Economic Research, NBER Working Paper Series 17929, March 2012. p. 19.

consequence of stifling the adviser's incentive to acquire information. More vigorous competition benefits consumers and reduces exploitation. . ."⁴⁵ Inderst and Ottaviani also concluded that the efficiency of particular arrangements could be impaired by factors outside the scope of their analysis. They remark "for instance, it is often claimed that customers' up-front willingness to pay for advice is inefficiently low because they are reluctant to lock-in a certain loss. To wit, while customers pay a commission only after they decide to buy a particular product or decide to invest at all, the sure payment of an up-front fee could loom excessively large."⁴⁶

Similarly, in the paper cited by DOL, Inderst and Ottaviani note "*professional financial advice. . . can play a key role in improving efficiency, as consumers often lack knowledge and capability to make informed decisions in their own best interest.*"⁴⁷ They go on to conclude that "given the various, potentially beneficial roles that commissions and other inducements play in some settings, *commission caps, bans, and other strict measures should be imposed only when disclosure has been proven (or can reasonably be expected) to fail.*"⁴⁸ Finally, the authors state "we anticipate that measures to enhance transparency will harness market forces to raise the quality of advice, without interfering with contractual practices."⁴⁹

E. Obstacles to Understanding Conflicts

The DOL states that IRA investors will not understand the potential for bias from adviser conflicts. The DOL further represents that disclosures of conflicts of interest don't provide enough information for IRA investors to make informed decisions. From this, the DOL concludes that because IRA investors cannot determine the quality of the advice that they receive and often do not understand or react to their advisers' potential conflicts of interest, they are unlikely to react to these conflicts. Consequently, *the DOL further concludes that additional disclosure will not be effective. At the same time, the re-proposed regulations include required disclosures that provide so much information that the average individual could not possibly process all the information.*

The only reference cited by the DOL relates to potential conflicts of insurance intermediaries. The paper cited (Beh and Willis (2009)) represents a qualitative analysis of potential problems with insurance intermediaries, but does not entail any attempt to measure the possible quantitative losses attributable to these conflicts.

In fact, the Beh and Willis paper also notes the "benefits" of insurance intermediaries. They state "Intermediaries, both independent and exclusive, perform valuable services that are desired and beneficial to both prospective insureds and insurers."⁵⁰ The authors further state

⁴⁵ Inderst, Roman and Marco Ottaviani. *How (not) to pay for advice: A framework for consumer financial protection*. August 2011, p. 1.

⁴⁶ *Ibid.* at p. 35.

⁴⁷ Inderst, Roman and Marco Ottaviani. *Financial Advice*. March 2012, p. 23.

⁴⁸ *Ibid.* at p. 24.

⁴⁹ *Ibid.* at p. 26.

⁵⁰ Beh, Hazel and Amanda M. Willis. *Insurance Intermediaries*. Connecticut Insurance Law Journal, Vol. 15:2, 2009, p. 579.

“Prospective insureds also benefit from the expertise and labors of intermediaries. A buyer, whether sophisticated or not, would be hard pressed to intelligently compare characteristics of insurance products beyond the premium charged without the expertise of an intermediary. For example, nuances in policy language, insurer solvency, claims practices, and reputation of the insurer are matters for which even sophisticated insureds need the counsel of intermediaries.”

V. DOL’s Compliance Cost Estimates Understate Actual Costs of Re-Proposed Regulations

DOL’s compliance cost estimates likely underestimate the actual costs of compliance and fail to account for the fact that these costs will be borne by consumers.

DOL estimates the compliance costs to be between \$2.4 billion and \$5.7 billion, mostly attributable to the costs of new fiduciaries complying with relevant prohibited transaction exemption requirement.⁵¹ DOL later states that they estimate the costs to be “less than approximately \$2.4 billion over 10 years”⁵² and “between \$2.4 billion and \$5.7 billion, or less if, as expected, more cost effective business models gain market share.”⁵³

DOL utilized data provided by the Securities Industry and Financial Markets Associations (SIFMA) to the Securities and Exchange Commission with respect to a different regulatory process to develop its cost estimates of the upper range (\$5.7 billion). However, DOL then dismisses the SIFMA estimates and refers to SIFMA’s data as significant overestimates and uses data from the Investment Adviser Association (IAA) also submitted to the SEC to derive a significantly smaller estimate (\$2.4 billion) of potential costs. However, closer scrutiny of the DOL estimates calls into question whether they have adequately captured the potential compliance costs of the re-proposed regulations.

For example, consider one component of the DOL estimates – the costs of updating computer systems to comply with the best interest contract exemption. DOL estimates these costs as follows: “The Department estimates that updating computer systems to create the required disclosures, insert the contract provisions into existing contracts, maintain the required records, and publish information on the Web site will require 100 hours of IT staff time for financial institutions during the first year that the financial institution uses the PTE. This IT work results in approximately 280,000 hours of burden during the first year and approximately 22,000 hours of burden during subsequent years at an equivalent cost of \$22.3 million and \$1.8 million respectively.”⁵⁴

However, a simple survey of major financial institutions reported significantly higher costs to comply with disclosure rules that required significantly less information than required under the

⁵¹ DOL Regulatory Analysis, at p. 157.

⁵² *Ibid.* at p. 178.

⁵³ *Ibid.* at p. 215.

⁵⁴ U.S. Department of Labor, Employee Benefits Security Administration, 29 CFR Part 2550, Proposed Best Interest Contract Exemption, Federal Register Vol. 80, No. 75, Monday, April 20, 2015, at p. 21982.

best interest contract exemption. The companies indicated the number of IT hours required to comply with the participant disclosure rules under DOL regulation 2550.404a-5 and the service provider disclosure rules under DOL regulation 2550.408b-2. One company reported spending more than 100,000 IT hours implementing these two regulations at a cost of approximately \$8.4 million. Another company reported spending more than 90,000 hours at a cost of over \$6.5 million. These examples suggest that the IT costs (a small component of DOL's overall costs of compliance) could be significantly underestimated, raising questions about the assumptions underlying the other components of DOL's costs of compliance. Note that the combined effect of these two companies (\$14.9 million) totals 67 percent of the DOL's total estimate of IT costs (\$22.3 million) for the first year under the regulatory analysis.

DOL estimates that the total costs of complying with the best interest contract exemption in the first year would be \$77.4 million, which includes producing and distributing the disclosures, complying with the recordkeeping conditions, staff time to create the original disclosure templates, and time to update IT systems. Assume that the company reporting IT costs of only \$6.5 million would have similar costs under the re-proposed regulation, even though it is likely that this company would have significantly greater costs. This implies that *this single company's IT costs in the first year would represent almost 8.5 percent of the total estimated industry costs of compliance with the best interest contract exemption. If the costs of both companies were considered, the combined IT costs for the two companies would represent nearly 20 percent of the total DOL estimated industry costs of complying with the exemption.*

In addition, another element of the potential costs of compliance that DOL ignores are the potential additional compliance costs related to the very short eight month transition period provided to implement the re-proposed regulations after they are finalized. DOL fails to discuss the potential costs of this in its economic analysis, but states the following in its discussion of possibly adjusting the compliance date:

“The Department understands that affected advisers and others in the financial industry will need time to modify business practices. A longer compliance period would defer and may reduce compliance costs. . . The Department invites comments as to whether the new proposal's compliance dates are workable, or whether dates should be adjusted with respect to some or all of the proposal's provisions and entities and transactions it affects.”⁵⁵

VI. DOL Fails to Account For Reduced Access to Financial Advice

DOL assumes that financial advisers will accept reduced fees without any change in either the quantity or quality of their investment advice, but basic economic analysis suggests that this assumption cannot be supported.

DOL assumes that the re-proposed regulation would have “little effect on access to investment advice.”⁵⁶ DOL states that the best interest contract exemption will be used and that firms

⁵⁵ DOL Regulatory Analysis, section 7.10, Adjust the Compliance Date, p. 207-208.

⁵⁶ DOL Regulatory Analysis, section 5.6, Indirect Cost, p. 176.

providing investment advice today will continue to provide advice after the regulation is enacted. However, basic economic principles suggest that, if an adviser's costs increase as a result of the re-proposed regulation, these costs will be borne by the adviser's customers either through decreased services or increased costs to the customer. The decreased services would involve either the exit of certain advisers from the market or a reduction in the intensity of advice provided by remaining advisers.

DOL ignores the substantial market disruptions that the re-proposed regulations could generate. First, as noted above, DOL's estimates of the compliance costs of the re-proposed regulations appear to understate significantly the real costs that could occur if the regulation is finalized. Second, many commenters have noted the potential for real market disruptions if the re-proposed regulations are finalized.

The Financial Industry Regulatory Authority (FINRA) CEO recently criticized the re-proposed regulations on the grounds that the regulation could cause firms to curtail or even discourage sales of IRAs.⁵⁷ Mr. Ketchum stated that the DOL proposal would create a bias against products with higher fees, even if they're the best recommendation for a client, and that it could force firms to move to a fee-based rather than a brokerage model.

SIFMA offered a counter-proposal to the DOL re-proposed regulation, contending that the *DOL rule would significantly increase broker liability risk and force clients to move from commission-based accounts to fee-based accounts, potentially pricing investors with modest assets out of the market.*

Garber et al. acknowledge the potential for contraction in the market. They state

“we think it is likely that many broker-dealers and investment advisors would exit the IRA market if the Proposed Rule were adopted only if the proportion of current revenues that would have to be replaced or increases in costs were fairly substantial.

*The number of professional advisors needed to serve the IRA market would be expected to decrease as a result of adopting the rule to the extent that broker-dealers exit the IRA market or take other steps to reduce their IRA-related advisory activities.”*⁵⁸

In the regulatory analysis, DOL notes the potential for reduced access to financial advice and states

“Nevertheless, *the Department takes seriously the risk that banning adviser conflicts could reduce access to advice for some IRA investors, and that not only their investing but also their saving might suffer as a result.* Even if the

⁵⁷ Schoeff, Mark Jr., *Finra's Ketchum criticizes DOL fiduciary rule*, Investment News, May 27, 2015.

⁵⁸ Garber et al, at p. 18.

potential for this result is limited, its severity is sufficiently great that *the Department agrees caution is required.*”⁵⁹

Further, DOL acknowledges the potential for reduced intensity of financial advice. In a section of the regulatory analysis relating to the decline in loads that has occurred over the last 20 years, *DOL states that a reduction in financial adviser compensation would lead to a decrease in either the level of service provided per customer or the cost of providing those services.*⁶⁰

However, despite significant comments from the industry about the potential adverse effects of the 2010 regulation, DOL assumes that the industry will develop models, such as robo-advisers, to take the place of face-to-face interactions that have proven successful in improving savings outcomes. In effect, the DOL analysis assumes that financial advisers will adapt in any way needed to ensure that they will maintain their same level of business.

Further, the DOL analysis attempts to counter claims about the effects of adoption of a similar rule in the United Kingdom. DOL states that the UK experience has only limited application to the re-proposed regulation. In addition, DOL cites a Towers Watson study as evidence that any actual exodus of financial advisers from the market was not the result of adoption of the UK rule.

However, *evidence from the United Kingdom suggests that advisers will exit the market, particularly for small accounts.* The DOL analysis cites a Towers Watson study to state that there is not an advice gap in the United Kingdom. In fact, the Towers Watson study notes

“A different picture is likely to emerge in considering individual consumer markets, as opposed to the total market . . . it has not been possible to analyse supply by segment . . . However, anecdotal evidence . . . suggest that advice capacity serving less affluent segments is likely to have reduced.”⁶¹

VII. Conclusions

A close review of the DOL regulatory impact analysis uncovers many overstatements and flawed assumptions. DOL cites numerous studies that they argue support the re-proposed regulation, yet closer scrutiny shows that many of the studies either are not relevant or caveat the findings on which DOL relies.

More troublesome is the fact that DOL dismisses virtually all of the information and data provided by the industry on the potential impact of the regulations even though this information could help inform the DOL estimates. Although the industry has consistently indicated its support for a fiduciary standard and has offered to work closely with DOL to develop workable rules, the DOL regulatory analysis reads more like a legal brief in litigation than a reasoned analysis supporting the re-proposed regulations.

⁵⁹ DOL Regulatory Analysis, section 3.2.2., Qualitative Discussion, p. 109.

⁶⁰ DOL Regulatory Analysis, section 3.4.3.2.3., Decline in loads, p. 123.

⁶¹ *Advice Gap Analysis: Report to FCA*, Towers Watson, 5 December 2014, p. 8.

DOL provided an extremely short period for review and comment with respect to the re-proposed regulations and an extraordinarily short period after finalization before the regulations become effective. These time periods suggest that DOL may implement the regulations without taking into account input from the industry that must comply with the rules.

UNINTENDED CONSEQUENCES: Potential of the DOL Regulations to Reduce Financial Advice and Erode Retirement Readiness

Prepared for Davis & Harman

by
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UNINTENDED CONSEQUENCES: POTENTIAL OF THE DOL REGULATIONS TO REDUCE FINANCIAL ADVICE AND ERODE RETIREMENT READINESS

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Davis & Harman, LLP commissioned this report on behalf of a coalition of financial services organizations that provide retirement services to millions of Americans.

I. Introduction and Executive Summary

DOL issued re-proposed regulations relating to the definition of a fiduciary for retirement savings purposes on April 14, 2015. In its regulatory impact analysis accompanying the re-proposed regulations, DOL estimated the effects of what it referred to as “conflicted advice” under current law, which DOL presumed to be any advice provided by a broker-dealer who accepted certain forms of compensation. DOL estimated that this “conflicted advice” costs investors \$210 to \$430 billion over 10 years and \$500 billion to \$1 trillion over 20 years. DOL’s analysis acknowledges that there may be positive effects to financial advice, but they do not attempt to measure these effects.

The re-proposed regulations would cast a broad swath. The general rule causes many activities of financial advisers to create potential fiduciary liability and the regulations do not provide workable safe harbors in the prohibited transaction exemptions. The regulations can be expected to create a chilling effect on financial adviser behavior. This is particularly true when the potential liabilities for violating the broad fiduciary standards and the likely costs of complying with safe-harbors in the prohibited transaction exemptions would exceed the value of providing certain services to retirement plans, their participants, and individual retirement arrangement (IRA) owners. Consequently, the regulations likely would result in a reduction of services provided to these parties, particularly for those with smaller account balances.

The reduced services would be reflected in a variety of ways, including (1) a decreased ability of financial service providers to accept small account balance clients under a brokerage model, (2) an increase in the fees charged with respect to small account balance clients, and (3) an overall reduced level of services provided by financial service advisers. On balance, the regulations are expected to hurt, rather than help, retirement plan participants,¹ small employers, and IRA owners with small account balances.

Conservative estimates of the combined reduction in retirement assets attributable to the unintended consequences of the re-proposed regulations suggest that the regulations could result in losses of retirement savings of \$68-\$80 billion each year. In addition, the re-proposed regulations will jeopardize retirement readiness for 11.9 million IRA and retirement participants. This 11.9 million figure is made up of individuals who either are unlikely to be retirement ready (6.1 million) or are at risk of failing to be retirement ready (an additional 5.8 million).

The following analysis provides details on the ways in which the re-proposed regulations would affect adversely IRA account owners, retirement plan participants, and small businesses.

¹ The fact that the best interest contract exemption does not apply to rollovers and distributions means that all retirement plan participants could be affected. Even if the exemption were to be made technically applicable, it is our understanding that financial institutions will not be able to use the exemption, making it effectively inapplicable.

II. UNINTENDED EFFECTS OF THE DOL REGULATIONS

A. *DOL Regulations Likely to Reduce Access to Financial Assistance*

When the Department of Labor (DOL) issued proposed regulations in 2010 revising the definition of a fiduciary for retirement plan purposes, many commenters criticized both the substance and the scope of the regulations. After a year of comment and review, the DOL announced plans to withdraw the proposal and issue a new proposed regulation. DOL issued the re-proposed regulations on April 14, 2015.

The re-proposed regulations would cast a broad swath. They have a general rule that causes many activities of financial advisers to create potential fiduciary liability and they do not provide workable safe harbors in the prohibited transaction exemptions. The regulations can be expected to create a chilling effect on financial adviser behavior. This is particularly true when the potential liabilities for violating the broad fiduciary standards and the likely costs of complying with safe-harbors in the prohibited transaction exemptions would exceed the value of providing certain services to retirement plans, their participants, and individual retirement arrangement (IRA) owners. Consequently, the regulations likely would result in a reduction of services provided to these parties, particularly for those with smaller account balances.

The reduced services would be reflected in a variety of ways, including (1) a decreased ability of financial service providers to accept small account balance clients under a brokerage model, (2) an increase in the fees charged with respect to small account balance clients, and (3) an overall reduced level of services provided by financial service advisers. On balance, the regulations are expected to hurt, rather than help, retirement plan participants,² small employers, and IRA owners with small account balances.

1. Re-proposed DOL Fiduciary Regulations

Overview of regulations – Like the 2010 proposed regulations, the re-proposed regulations provide a broad expansion of the definition of a fiduciary with respect to retirement plans and IRAs. Under the general rule of the re-proposed regulations, individuals will be considered fiduciaries if they either (1) represent that they are acting as an ERISA fiduciary or (2) make individualized recommendations regarding investments, rollovers, or distributions pursuant to an agreement, arrangement, or understanding that the advice being provided is individualized or specifically directed to the recipient for consideration.

Generally the following types of advice could trigger fiduciary liability: (1) investment recommendations, including a recommendation to take a distribution of benefits or as to the investment of securities or other property to be rolled over or otherwise distributed from a plan;

² The fact that the best interest contract exemption does not apply to rollovers and distributions means that all retirement plan participants could be affected. Even if the exemption were to be made technically applicable, it is our understanding that financial institutions will not be able to use the exemption, making it effectively inapplicable.

(2) investment management recommendations, including recommendations as to the management of securities or other property to be rolled over or otherwise distributed from the plan; (3) appraisals, fairness opinions, or similar statements whether verbal or written concerning the value of securities or other property provided in connection with a specific transaction (except ESOP valuations); or (4) recommendations of persons to provide any advice described in 1-3 above for a fee or other compensation.³

Even a casual comment that could be considered as relating to the above types of advice would give rise to fiduciary status. Thus, the proposed regulations make many interactions that currently occur between advisers and retirement plans, plan participants, and IRA owners subject to potential fiduciary liability and also, pursuant to the prohibited transaction rules, prohibit many forms of compensation that advisers currently receive. The consequences of violating the fiduciary standards for advice with respect to retirement plans and IRAs can be significant, as discussed briefly below.

Sanctions for violating regulations – Under ERISA, fiduciaries are subject to personal liability for any loss arising from a breach of fiduciary duty. Thus, ERISA recognizes a private right of action against a fiduciary for a breach of fiduciary liability. The ERISA personal liability rules apply to qualified retirement plans, but do not apply to IRAs.

Fiduciaries are also subject to the prohibited transaction provisions of ERISA and the Internal Revenue Code (IRC). These prohibited transaction provisions apply to retirement plans and their participants, as well as IRAs.

Once a person is a fiduciary, the person is prohibited under the prohibited transaction provisions from engaging in certain types of transactions, including transactions in which the compensation of the fiduciary can increase based on the fiduciary's advice. Thus, under the re-proposed regulations, certain common forms of compensation arrangements, such as brokerage or insurance commissions in connection with investment transactions made by a plan, plan participant, or IRA, would be prohibited under the prohibited transaction provisions, absent a workable exemption.

The excise taxes on prohibited transactions imposed under the IRC represent a potentially substantial penalty for violations, which equals an annual 15 percent of the amount involved with respect to the prohibited transaction. However, if the prohibited transaction is not corrected within a specified period, the excise tax equals 100 percent of the amount involved.

³ The following types of activities would be excluded from the definition of a fiduciary: sales pitches involving large plan clients; counterparties in certain swap transactions; platform providers who merely make available a roster of investment options that plan administrators can use to choose plan investment menus; consultants who only provide investment data or identify investments that meet objective criteria set by the plan; recommendations made to plan sponsor fiduciaries by their own employees; valuations provided for reporting and disclosure purposes rather than in connection with transactions; and financial “investment or retirement” education that does not include specific investment recommendations or even examples of specific types of investments.

As a practical matter, financial advisers cannot risk the sanctions imposed if they violate the fiduciary standards, especially the prohibited transaction rules. Thus, these advisers will have to modify their activities in ways that ensure that they are complying with the regulations.

Prohibited transaction exemptions – The re-proposed regulations do provide certain new prohibited transaction exemptions (PTEs), as well as revising some existing exemptions. The prohibited transaction exemptions allow individuals who meet certain requirements to avoid the potential prohibited transaction excise taxes. A problem arises because (1) the new prohibited transaction exemptions do not cover a number of important and common situations, and (2) the new best interest contract exemption is apparently so burdensome in its conditions as to not be usable.

The proposed “best interest contract” prohibited transaction exemption would permit advisers who are fiduciaries to receive compensation for services provided to certain plans, plan participants, and IRA owners. The exemption applies to advice (1) provided to plan participants, IRA owners, and sponsors of plans that have less than 100 participants (and do not allow participants to control the investment of their own accounts, which is not a typical situation) and (2) that relates to the purchase, sale, or holding of certain assets. This exemption, if applicable, would permit fees such as commissions, 12b-1 fees, and revenue sharing for investment transactions for plan participants, beneficiaries, IRA owners, and a tiny portion of small plans with less than 100 participants.

The requirements that apply to the best interest contract exemption include the following:

- The adviser and his or her company must contractually agree to adhere to “Impartial Conduct Standards” in providing advice and must comply with those standards.
- The contract must state that the adviser is a fiduciary.
- The adviser’s company must warrant that it has policies and procedures designed to mitigate the dangers of conflicted advice (e.g., the adviser’s company cannot have bonuses, special awards, or other incentive payments that would encourage advisers to make recommendations that are not in the best interest of the customer.)
- The contract must disclose all conflicts of interest and make information about direct and indirect fees available.
- The contract cannot have a provision under which the customer “waives or qualifies its right to bring or participate in a class action or other representative action in court.”
- The adviser must provide a chart to the customer with the total cost of the asset over 1, 5, and 10 year periods, as a dollar amount, making reasonable assumptions about future investment performance. The chart must include acquisition costs (such as commissions), ongoing costs (such as revenue sharing), disposition costs and other costs that reduce the investment’s return. Total cost includes the expense ratio with respect to a mutual fund, for example.
- Every year, the adviser must provide information to the customer about that year’s transactions, including the total dollar amount of all indirect compensation received by the adviser and his company during the year attributable to the customer.
- The adviser’s company must maintain a webpage with detailed information, updated at least quarterly, about all direct and indirect compensation payable to the adviser, his company, and all company affiliates with respect to every single asset purchased, sold, or

held by a retirement customer during the last 365 days (excluding only certain assets not commonly purchased). In addition, the webpage must include the same information about all assets that a retirement customer could possibly purchase (excluding certain assets not commonly purchased).

- The adviser may provide advice, but all investment decisions must be made by the customer. Thus, discretionary accounts in which the adviser has discretionary authority over the assets, pursuant to guidelines from the customer, are not covered by the exemption.
- The exemption only applies to certain assets that are commonly purchased by retirement customers.
- Firms would be required to maintain specified data on investments and returns for six years.

The best interest contract exemption would require companies to provide and maintain a massive amount of information and data for customers in order to qualify. Some of the information is not currently collected by the companies, leading to substantial startup costs for companies interested in using the exemption. In many cases, customers would be overwhelmed by the amount of information they would receive with respect to investments.

Companies are likely to find that the costs of providing the required information to qualify for the prohibited transaction exemption would exceed the value of getting or retaining a small account. As a result, conditions imposed by the proposed exemption create an incentive for companies to significantly reduce assistance to individuals with smaller accounts. The exemption would require companies to provide far more data and disclosure to smaller accounts compared to current disclosures required to be provided to a larger retirement plan (e.g., a plan with 10,000 participants).

For example, under the re-proposed exemption, financial institutions would be required to disclose, and update at least quarterly, all direct and indirect compensation received with respect to all assets of all retirement customers of the financial institution and all affiliates for the past 365 days as well as the same information with respect to all assets that a retirement customer could possibly purchase (other than certain assets not commonly purchased).

In a recent paper, the U.S. Chamber of Commerce argued that an overly broad general rule defining a fiduciary (with prohibited transaction exemptions) creates a regime that will be “(1) lengthy and protracted, (2) burdened with conditions, limitation, and requirements, and (3) generally ineffective in addressing the needs of the employee benefits community.”⁴ The paper notes “despite best efforts by the DOL, we remain concerned that no matter how well-crafted the PTEs are, they will prove to be insufficiently narrow and inflexible to accommodate the many beneficial ways that financial professionals serve the needs of investors today and in the future”⁵ and states “by creating a series of PTEs to narrow an overly broad regulation the DOL

⁴ U.S. Chamber of Commerce, *Using PTEs to Define a Fiduciary Under ERISA. Threading the Needle with a Piece of Rope*, Released February 20, 2015, p. 1.

⁵ *Ibid*, at p. 1.

is...unintentionally creating barriers to finding better ways to improve the system and protect investors.”⁶

Most importantly, initial indications suggest that very few, if any, financial institutions could satisfy the best interest contract exemption, thereby practically eliminating this exemption. In most contexts, the prohibited transaction rules would bar financial professionals from providing services to customers under the brokerage model.

Simple examples of the likely effects of the re-proposed regulations help to demonstrate their unintended consequences. The result would be a decline in the amount of financial education, assistance, and advice available to IRA owners and retirement plans and their participants.

2. DOL Regulations Likely Would Reduce Access to Financial Markets For Small IRAs and Small Business Retirement Plans

The DOL regulations likely would reduce the availability of financial assistance for the owners of small account IRAs and small business retirement plans. A number of provisions create this result.

First, the seller’s exception in the regulation does not apply to individuals and small businesses, eliminating the marketing of products to these groups.

In some cases, it is difficult to distinguish the difference between selling (e.g., “our investment products can help you achieve a secure retirement”) and advice (e.g., “we advise you to invest in these products”).

Almost any discussion of a company’s own products or services with any individual or small business is a fiduciary discussion. Thus, companies would be prohibited from discussing their own services, such as creating rollover accounts or managed account services.

Any interviews to be hired would create potential fiduciary liability for the financial adviser; e.g., merely by recommending to a potential customer that he or she be hired could result in fiduciary liability and a prohibited transaction.

The 2010 proposed regulations provided a seller’s exception to the fiduciary standards under which a seller who makes clear that he or she is selling and not advising is not a fiduciary. The elimination of this seller’s exception in the re-proposed regulation makes it much more difficult and risky to provide information that may be considered advice. In addition, the best interest contract exemption does not apply to the vast majority of small business plans and generally will be unusable with respect to small accounts.

Small businesses need more assistance than large businesses in choosing investment options or managed account services to offer to their employees. But eliminating the seller’s exception and not having a workable prohibited transaction exemption means that almost no assistance can be

⁶ *Ibid*, at p. 1.

provided to these small businesses. Doing so would create a risk of fiduciary status and the resulting potential liability for hefty prohibited transaction excise taxes. This occurs because financial institutions typically earn different amounts on the different options that a small business can choose to offer its employees. As a result, financial advisers would not be able to provide services to these types of customers.

Ultimately, the lack of a seller's exception to the fiduciary standards and of a workable prohibited transaction exemption for individuals and small businesses would discourage access and participation in the retirement plan market.⁷

Effect on Establishing IRAs – The re-proposed regulation would also impact the availability of IRAs in the marketplace. In 2011, Oliver Wyman studied the effect of the 2010 proposed regulation on IRA owners.⁸ Because the re-proposed regulation fails to provide a workable prohibited transaction exemption, the 2011 study remains relevant to the analysis of the effects of the re-proposed regulations.⁹

Under the regulation, IRA owners would have the following options: (1) if the account is large enough, move to an advisory relationship, which may increase fees, especially for buy and hold investors, (2) if the account is not large enough for an advisory relationship, leave the money in the account, but lose access to an adviser, (3) cash out the savings from the IRA and either spend the money or add the assets to an account that is not tax favored, or (4) roll the IRA assets over to another tax-favored retirement savings account, such as an employer plan, if available.⁹

A study commissioned by the DOL relating to the 2010 proposed regulations provides information relevant to the re-proposed regulations. This study, released in February 2015, acknowledges that the regulations could have an adverse effect on some portion of IRA investors and that, as a result, some IRA owners would be worse off under the regulations.¹⁰ The study concludes that unsophisticated investors in particular, those who need the most assistance in saving for retirement, would have lower IRA contributions under the regulations because they either do not have access to a financial adviser or because the intensity of financial assistance they receive would decline. In addition, the study states “it is far from clear whether unsophisticated investors would earn higher returns on their own than they would if they receive conflicted advice.”¹¹ The study suggested that the primary disadvantage for sophisticated investors would be the higher time spent by the investor on investment options due to decreased

⁷ Small business employees tend to have lower access to retirement plans compared to their counterparts in larger businesses. Refer to the Bureau of Labor Statistics, National Compensation Survey (2014). In addition, individuals eligible to make IRA contributions tend to have very low take-up rates. Refer to the IRS, SOI, Individual Income Tax Return data, 2013.

⁸ Oliver Wyman, *Assessment of the impact of the Department of Labor's proposed "fiduciary" definition rule on IRA consumers*, NYC-ZPR00111-002, April 12, 2011.

⁹ This option will not always be available to an individual.

¹⁰ Garber, Steven, Jeremy Burke, Angela Hung, and Eric Talley. *Potential Economic Effects on Individual Retirement Account Markets and Investors of DOL's Proposed Rule Concerning the Definition of a 'Fiduciary.'* Rand Labor and Population, PR-1009-DOL, February 2015, prepared for the Department of Labor. The authors do not attempt to measure the quantitative effects of the regulation, stating that available information makes it difficult to estimate how much any particular group of investors is likely to be helped or harmed by adoption of the regulation.

¹¹ *Ibid*, at p. 27.

or no time spent by a financial adviser under the regulations. Thus, the regulations would harm unsophisticated investors more than sophisticated investors.

3. DOL Regulations Would Reduce Availability of Educational Materials for Retirement Plan Participants

Current Participants – Under current law, an employer or service provider can provide educational materials to employees without being considered a fiduciary. This rule allows educational materials to include (1) guidance on the extent to which an individual should invest in different asset classes (such as large and small cap equity funds, and long and short-term bond funds) based on the individual’s age and other characteristics and (2) examples of specific investments that fit within the asset classes. The re-proposed regulations continue to permit the educational materials described in (1) to be provided to retirement plan participants, but would not allow examples of specific investments as these would be considered fiduciary advice, not participant education.

When providing educational assistance to plan participants, the re-proposed regulations would not allow educators to provide examples of funds that fit within recommended asset classes, as these “examples” would be considered fiduciary advice.

As a result of the re-proposed regulations, plan participants would get less, rather than more information, leaving them to make decisions about their retirement plan investments without knowing how to use the educational assistance they are provided. Because many plan participants are ill-equipped to select investment options on their own, the re-proposed regulations would lead to suboptimal decision-making with respect to retirement savings.¹² The regulatory analysis to a 2011 DOL regulation relating to prohibited transactions estimates that individuals make more than \$100 billion per year in mistakes with respect to their retirement savings.¹³

Participants Terminating Employment – Under the re-proposed regulations, the best interest contract prohibited transaction exemption does not apply to advice relating to plan distributions or rollovers and does not apply to advice or marketing regarding which company to use to provide investment services, such as managed account or IRA services.

An employee who is terminating employment cannot receive information from a broker dealer or a call center offered by the plan’s financial services adviser concerning the employee’s options with respect to his or her retirement savings. Because the best interest contract prohibited transaction exemption does not apply to distributions and rollovers, these entities cannot use the exemption to protect themselves from the prohibited transaction rules. (Even if the best interest contract exemption were to be made applicable to distribution and rollover advice, it is our understanding that as a practical matter the exemption is unusable.) Thus, while a broker-dealer or call center could provide factual

¹² This analysis is discussed in greater depth below.

¹³ Federal Register, Volume 76, No. 206, Rules and Regulations, Tuesday, October 25, 2011.

information to a terminating employee about his or her options to roll over assets or leave them in the employer's plan, the broker-dealer or call center could not discuss with the employee any products or services relating to the broker-dealer or financial institution. Rather than promote the products of other companies, these broker-dealers and call centers would stop providing assistance to terminating employees.

If employees lose access to assistance at this critical choke point in their working career, some employees will be more likely to take cash outs of some or all of their accumulated retirement savings. Employees will be cut off from a logical form of assistance and will lose their normal source of information on distributions and rollovers. A 2014 study by Quantria Strategies, LLC estimated that the loss of call center and broker dealer assistance at job termination could lead to increased cash outs of \$20-32 billion annually.¹⁴

B. Unintended Effects on Retirement Readiness

Retirement readiness provides a sense of how well-equipped an individual is to meet their financial needs during retirement. Traditionally, this measure focused on income replacement rates. Historical measures of retirement readiness posit that individuals could maintain their preretirement standard of living if their retirement income replaced 80 percent of their preretirement income. As retirement plans shifted from defined benefit to defined contribution plans, the focus of retirement readiness includes whether individuals will have sufficient assets to meet anticipated expenses. The re-proposed regulations likely would affect adversely the account balances and assets of employees, which reduces the retirement readiness for defined contribution account holders.

1. Measures of Retirement Readiness

The Employee Benefit Research Institute (EBRI) devised the Retirement Security Projection Model (RSPM) to simulate (by age and income) the percentage of the population not having adequate retirement income to cover average expenses and uninsured health care costs (including long-term care costs) at age 65 or older throughout retirement.¹⁵ EBRI's Retirement Readiness Rating (RRR) for 2014 found that 56.7 percent of early Baby Boomers had sufficient retirement readiness, compared to 58.5 percent for late Baby Boomers, and 57.7 percent for Generation X'ers.¹⁶ An EBRI 2012 analysis examined more closely the retirement readiness of these groups and found that 18.0 percent of early Baby Boomers had less than 80 percent of what is needed to be considered adequate retirement readiness and 31.5 percent had 80-100 percent of what is

¹⁴ Quantria Strategies, LLC, *Access to Call Centers and Broker Dealers and Their Effects on Retirement Savings*, April 9, 2014.

¹⁵ VanDerhei, Jack. *What Causes EBRI Retirement Readiness Ratings to Vary: Results from the 2014 Retirement Security Projection Model*. Employee Benefit Research Institute, EBRI Issue Brief No. 396, February 2014.

¹⁶ Early Baby Boomers include individuals born between 1948 and 1954, the Late Boomers were born between 1955 and 1964, and the Generation X'ers were born 1965-1974.

needed, compared to 17.2 percent and 31.1 percent of late Baby Boomers, and 19.4 percent and 31.4 percent of the Generation X'ers.¹⁷

Fidelity conducted year-long research to create a Retirement Preparedness Measure (RPM), which resulted in findings similar to the EBRI RRRs.¹⁸ Fidelity found that 55 percent of Americans are in a yellow or red zone, meaning that they are in danger of not fully covering essential expenses like housing, health care, and food in retirement.¹⁹

AON Hewitt produced yet another measure of retirement income adequacy in a 2012 report.²⁰ The AON Hewitt report calculates that an individual needs to accumulate assets that are 15.9 times final pay to cover retirement expenses through an average life expectancy (age 87 for males and age 88 for females). According to AON Hewitt, Social Security covers 4.9 times pay, leaving 11.0 times pay to be covered by other means. According to the report, employees who retire at age 65 after a full career will, on average, accumulate 8.8 times pay for retirement savings.

2. The Impact of Financial Literacy on Retirement Readiness

A substantial body of research has explored the causes of inadequate retirement savings in the United States. One problem commonly identified relates to financial literacy; i.e., individuals lack basic understanding of key financial concepts.

Across all age groups, individuals lack essential knowledge of basic financial concepts, including interest compounding, the effects of inflation, and diversification of risk.²¹ Limiting access to financial advice further limits the availability of much needed financial education.

In multiple surveys and studies, the research shows that a significant percentage of U.S. workers (1) cannot answer correctly the most simple multiple choice questions on issues of basic financial literacy, (2) fail to plan adequately for retirement, (3) consistently underestimate the amount of retirement savings they will need, and (4) make decisions, such as cashing out their retirement savings prior to retirement age, that adversely impact their long-term retirement savings.²²

¹⁷ VanDerhei, Jack. *All or Nothing? An Expanded Perspective on Retirement Readiness*. Employee Benefit Research Institute, EBRI Notes, Vol. 33, No. 11, November 2012.

¹⁸ The RPM estimates the percentage of total estimated retirement expenses that individuals are expected to cover based on a survey of 2,265 households and data from the Consumer Expenditure Survey and the Medical Expenditure Panel Survey.

¹⁹ See *How ready is America to retire*, accessed at https://www.fidelity.com/bin-public/060_www_fidelity_com/documents/picture-of-americas-retirement-readiness.pdf.

²⁰ AON Hewitt, *The Real Deal. 2012 Retirement Income Adequacy at Large Companies*, 2012.

²¹ See, for example, Lusardi, Annamaria and Olivia S. Mitchell. *Financial Literacy and Retirement Planning in the United States*, February 1, 2011. Lusardi, Annamaria and Olivia S. Mitchell. *Financial Literacy and Planning: Implications for Retirement Wellbeing*. University of Michigan Retirement Research Center, MRRC Working Paper n. 2006-144.

²² The list of references at the end of this paper contains multiple sources for research relating to financial literacy and retirement saving.

Lusardi and Mitchell (2010), using results from the American Life Panel (ALP) survey, found that financial literacy relates positively to retirement planning even after accounting for other factors, such as age, education, and income.²³ The authors note that “lack of financial knowledge is a major factor driving poor retirement planning.”²⁴ Thus, individuals who lack financial literacy are less likely to plan for retirement and less likely to demonstrate retirement readiness.²⁵

Low levels of financial literacy present particularly acute problems for certain demographic groups, especially African-Americans and Hispanics.²⁶ Kuan et al. (2015) examined a cohort of continuously employed workers at a large, geographically diverse employer over an eight-year period (2003-2010) and found significant differences in 401(k) savings rates by employee ethnicity.²⁷ Kuan et al. found that, among workers with similar pay, African-American and Hispanic workers are less likely to participate in an employer’s 401(k) plan, contribute less to the plan when they do participate, and tend to take cash outs of their retirement savings more often.

Lusardi and Mitchell (2014) found that African-Americans and Hispanics generally have low levels of financial literacy.²⁸ The TIAA-CREF Institute specifically examined the financial literacy of college-educated Hispanics and found low financial literacy even among this educated group; the study found that only 32 percent of college-educated Hispanics demonstrate basic financial literacy and only 12 percent demonstrate high financial literacy.²⁹

The lack of financial literacy among these demographic groups translates to average account balances in 401(k) plans that are significantly lower for African-Americans and Hispanics than other demographic groups.³⁰ At the lowest salary levels, the average account balances of African-Americans and Hispanics are only approximately 60 percent of the average for whites. The percentage disparity becomes smaller as salaries increase, but even at the highest salary levels, the average account balances of African-Americans and Hispanics tend to be

²³ Lusardi, Annamaria and Olivia S. Mitchell. *How ordinary consumers make complex economic decisions: Financial literacy and retirement readiness*. Center for Financial Studies (CFS) Working Paper No. 2010/11, April 2010.

²⁴ *Ibid.* p. 2.

²⁵ Amromin, Gene, Itzhak Ben-David, Sumit Agarwal, Souphala Chomsisenphet, and Douglas D. Evanoff. *Financial Literacy and the Effectiveness of Financial Education and Counseling: A Review of the Literature*. Accessed at: http://www.chicagofed.org/digital_assets/others/region/foreclosure_resource_center/more_financial_literacy.pdf. Amromin et al. reviewed the literature on financial literature and concluded that the surveys and studies varied significantly in content and sample population, but generally agreed on the following: “(1) a large proportion of consumers are not financially literate, even among the wealthiest and most educated population segments, (2) financial literacy rates vary consistently by demographic groups, tending to be high for those with more wealth and education, for men (although results vary), and for whites (in the U.S.), and (3) financial illiteracy leads to welfare-reducing financial behavior and outcomes.”

²⁶ *Ibid.*, at p. 12.

²⁷ Kuan, Kai Yuan, Mark R. Cullen, and Sepideh Modrek. *Racial Disparities in Savings Behavior for a Continuously Employed Cohort*. National Bureau of Economic Research, NBER Working Paper 20937, February 2015.

²⁸ Lusardi, Annamaria and Olivia S. Mitchell. *The Economic Importance of Financial Literacy: Theory and Evidence*. *Journal of Economic Literature*, 52(1), 2014.

²⁹ *Hispanic Personal Finances: Financial Literacy and Decisionmaking Among College-Educated Hispanics*. TIAA-CREF Institute, May 2015.

³⁰ *401(k) Plans in Living Color. A Study of 401(k) Savings Disparities Across Racial and Ethnic Groups*. Ariel Education Initiative, Aon Hewitt, Joint Center on Political and Economic Studies, and the Raben Group, 2012.

approximately 70 percent of the average for whites. While a variety of factors (e.g., lower participation and contribution rates) account for these disparities, preretirement cash-outs of retirement savings represent one significant factor (discussed in greater detail below) affecting account balances for all workers, but particularly for minority and ethnic groups.

3. The Benefits of Financial Assistance

Access to financial advice counters the effects of a lack of financial literacy. Even DOL acknowledges that there may be so-called “intangible benefits” to financial advice that are not measured. In fact, the DOL regulatory analysis for the re-proposed regulations states, with respect to studies that discuss the potential benefits of financial advice,

“However, they also find robust evidence that advice affects savings styles and levels, and suggest that the higher fees paid by advised clients might reflect payment for broader financial advice.”³¹

A recent report commissioned by the DOL specifically addresses the benefit of financial advice with respect to unsophisticated (e.g., financially illiterate) investors. Garber et al. (2015) discuss the potential economic effects on individual retirement markets and investors of the 2010 DOL proposed regulation.³² This analysis applies to the re-proposed regulations as well. Garber et al. state that, without the proposed regulation “unsophisticated investors benefit from time savings” by using a financial adviser and “also benefit from help in choosing investment products (relative to those making these choices without professional help) and from coaching to open IRAs, contribute appropriate amounts, and so on.”³³

Garber et al. state that a key question concerning the proposed regulation relates to how the rule would affect the well-being or welfare of investors. They note that adopting the rule would likely help some investors and hurt others; they conclude by stating “we cannot predict whether the benefits to IRA investors would outweigh their costs for any particular type of IRA investor or in the aggregate.”³⁴

A 2014 Financial Engines/AOL Hewitt attempts to quantify the use of “help” in defined contribution plans.³⁵ The Financial Engines/AON Hewitt study provides important information with respect to participants who do not receive any form of help, finding that 60.5 percent of non-help participants had inappropriate levels of risk (either too high or too low) and lower returns (332 basis points lower, net of fees). The study also found that near retirees needed the most help, with this group having the widest variability in risk levels.

³¹ U.S. Department of Labor, Fiduciary Investment Advice, Regulatory Analysis, Section 3.2.3.5, Eroded IRA Returns, p. 94, April 14, 2015.

³² Garber, Steven, Jeremy Burke, Angela Hung, and Eric Talley. *Potential Economic Effects on Individual Retirement Account Markets and Investors of DOL’s Proposed Rule Concerning the Definition of a ‘Fiduciary.’* Rand Corporation, Rand Labor and Population, RR-1009-DOL, February 2015, prepared for the Department of Labor.

³³ *Ibid.* at 23.

³⁴ *Ibid.* at 26.

³⁵ Financial Engines, AON Hewitt, *Help in Defined Contribution Plans: 2006 through 2012, May 2014.*

While DOL suggests that the use of target-date funds would help individuals who do not have access to financial assistance, the Financial Engines/AON Hewitt study noted that defaults drove participants into target-date funds, but that most participants viewed target-date funds as “additional fund options in their plans and not as an all-in-one fund solution.”³⁶

A recent study found that, among similarly situated individuals (middle-income Baby Boomers, defined as those with annual household income between \$25,000 and \$100,000), individuals who work with a financial professional were more likely (25 percent) to have investable assets over \$500,000 than those who do not work with a financial professional (less than 10 percent).³⁷

The length of time an individual has worked with a financial professional also contributes to higher levels of assets. Among those who worked with a financial professional for less than two years, 43 percent reported assets less than \$100,000, 38 percent reported assets between \$100,000 and \$500,000, and 19 percent reported assets exceeding \$500,000. On the other hand, for individuals who had worked with a financial professional for at least 10 years, 24 percent reported assets less than \$100,000, 47 percent reported assets between \$100,000 and \$500,000, and 28 percent reported assets exceeding \$500,000.

The Consumer Financial Protection Bureau (CFPB) indicates that individuals with lower levels of financial literacy need ‘financial capability practitioners,’ or individual advisers who can engage in behaviors to improve their financial well-being. The goal is to link individuals’ behaviors to their personal financial goals, while helping them to cultivate important skills and strategies. These advisers offer three important areas where financial advisers play an important role in developing financial capabilities, including: (1) providing reliable financial information; (2) assisting in using this information to make sound financial decisions; and (3) executing financial decisions with services to monitor the accounts so that the participant may adapt and modify their behaviors, as needed.³⁸

However, these services are often the same as those provided by broker-dealers that provide advisory services to IRA and retirement plan participants, both individuals and small businesses. Eliminating these services could result in lower levels of financial well-being.

Participant Behavior and the Desire to Avoid Risks – As noted above, participants who select their own investments often choose inappropriate levels of risk (either too low or too high). In addition to encouraging individuals to begin saving for retirement and to save appropriate amounts, financial advisers may help individuals select appropriate levels of risk for their retirement savings investments. DOL’s focus on rates of returns neglects to account for the many ancillary benefits of using a financial adviser, including risk management.

³⁶ *Ibid.* at 42.

³⁷ Center for a Secure Retirement, *The Middle-Income Boomer Retirement Gap: Savings, Education, and Advice*, November 2014.

³⁸ Consumer Financial Protection Bureau, *Financial Well-Being: the Goal of Financial Education*, January 2015.

The 2015 PIMCO Defined Contribution Consulting and Support survey highlights the many factors that drive good investment decisions.³⁹ For example, the survey indicates the following considerations:

- When evaluating default strategies, over 95 percent of consultants believe it is important or very important to evaluate the glide path structure, fees, diversification of underlying investments, probability of meeting retirement income objective, and quality of underlying investments.
- Consultants ranked “maximizing asset returns while minimizing volatility relative to the retirement liability” and “maximizing median participant income replacement” as the most important objectives when evaluating glide paths.
- When evaluating income replacement distributions, the vast majority (85 percent) of consultants believe a tighter distribution (one with less downside and less upside) is more attractive. For example, given a choice of hypothetical distributions, over four times (4.3x) as many consultants selected the one with 10 percent less downside and 60 percent less upside than the one with the greatest upside.⁴⁰

³⁹ PIMCO, *Defined Contribution Consulting Support and Trends Survey*, 9th Annual 2015 Survey Highlights.

⁴⁰ *Ibid.* p. 4.

III. Effects of the Re-Proposed Regulations

Understanding the effects of the re-proposed DOL regulations rests on understanding the relationships between the various groups identified previously – small businesses, small accountholders, IRA accountholders, qualified plan participants, and participants who terminate employment with a qualified plan. In addition to identifying these groups, it is important to understand the composition of each, particularly with respect to financial literacy and lower than average savings and retention rates for retirement plans.

It is also important to distinguish between paid and unpaid financial services that individuals receive from advisers and broker-dealers. Individuals who directly hire a financial adviser tend to be higher income and have more general education than other individuals. That is not the case for individuals who contact a call center or utilize the services of a broker-dealer associated with their employer's retirement plan. Information that we received from financial services firms suggests that a wide range of individuals utilize this type of assistance.⁴¹

The counter population to this is the small accountholder, individuals with lower levels of educational and financial literacy, as well as low-income individuals. The individuals meeting these characteristics tend to be represented by a disproportionately large portion of minority individuals. Research indicates that minority populations tend to have lower account balances that result from lower levels of financial literacy and lower incomes. Restricting financial advice would eliminate an important source of potential information and guidance.

As discussed above, the re-proposed DOL regulations would result in the reduction of financial assistance provided with respect to retirement savings, a finding that the DOL does not dispute.⁴² Because the re-proposed regulations provide unworkable and costly PTEs, access to financial assistance would undoubtedly decline, particularly for small employers with respect to retirement plans and small account IRAs.

DOL's regulatory analysis assumes that financial advisers will develop so-called "low fee" alternatives for these groups, but the absence of workable PTEs would likely stymie these efforts both in the short and long-run. In fact, an analysis commissioned by the DOL acknowledges that the 2010 proposed regulations (and, similarly, the re-proposed regulations) could result in substantial increases in direct fees, which could price many retail investors out of the market for financial advice.⁴³

DOL suggests that the decline in availability of financial advice may be a desirable outcome of the regulations, eliminating what they refer to as "conflicted" advice. However, the decline in

⁴¹ For example, one company's call center data for the first quarter of 2013 indicated that nearly 80 percent of the calls related to individuals with no more than \$50,000 of assets in their retirement savings plan and nearly 50 percent of the calls related to individuals with no more than \$5,000 in the plan. Nearly 60 percent of the calls related to individuals under age 50 and more than 60 percent related to individuals with less than 10 years of service with the employer.

⁴² The Garber et al. study commissioned by the DOL confirms this. However, the DOL may question the extent to which this result will occur.

⁴³ Garber et al, *supra*.

availability of financial advice is likely to hurt the very populations that most need assistance about retirement savings decisions. We discuss the potential effects for these populations below.

Millions of Americans use the services of broker-dealers and other sources of assistance each year to assist them with their retirement savings. For example, millions of employees contact call centers associated with their retirement plan each year.⁴⁴ The financial services firms view their call center operations as an important way to help educate employees on the importance of preserving their retirement savings. In addition, some employees have direct access to a broker-dealer for assistance. This might occur if an individual has set up an IRA using a broker-dealer or if an employer (often a small employer) has a broker-dealer who helped the employer establish a retirement plan for employees.

In many cases, advisers or broker-dealers assist employees who could not otherwise afford to hire a financial adviser. While it is more difficult to quantify the extent to which employees might access a broker-dealer for assistance for help understanding their options with respect to their retirement savings, this access represents another important way in which employees receive assistance with respect to their retirement savings and, more generally, their financial literacy. As discussed above, a clear relationship exists between access to financial assistance and financial literacy.

Moving away from the generalized experiences that plan participants and individuals face, it is important to consider the specific groups that will face the potential for unintended consequences of the re-proposed regulations. These groups include IRA account holders, small business plans (including IRAs and qualified plans), and current or terminating plan participants seeking investment options or tax advice.⁴⁵

A. Individual Retirement Arrangements

At the end of the third quarter of 2014, IRA assets totaled \$7.3 trillion, representing 30 percent of total retirement assets in the United States.⁴⁶ According to the Investment Company Institute (ICI), IRA owners tend to be savers; the median financial assets of IRA-owning households were almost six times larger than the median financial assets of other households.⁴⁷ As indicated

⁴⁴ Some of the calls represent basic transactions, such as a balance inquiry or providing an address change. For some companies, the initial call will be handled by a basic service representative, who will handle the most basic inquiries and will transfer the caller to a licensed representative for any other question or request.

⁴⁵ It is also important to understand these specific groups have considerable overlap. For instance, an IRA account holder may have made direct contributions to their IRA or rolled over contributions from a qualified plan (after terminating employment). The IRA account holder may be a small business person (holding a SEP or SIMPLE plans) that would like to transition to a qualified defined contribution plan. Plan participants often rely on the plan educational materials (regarding investment diversity) to make their investment decisions and then, after terminating employment seek to continue that investment plan through an IRA.

⁴⁶ *The Role of IRAs in U.S. Households' Saving for Retirement, 2014*. Investment Company Institute, ICI Research Perspective, Vol. 21, No. 1, January 2015.

⁴⁷ *Ibid.* Also, the Oliver Wyman study found that households owning IRAs had median IRA assets of \$50,000 and median household financial assets of \$200,000, compared to median household financial assets of \$35,000 for non-IRA households.

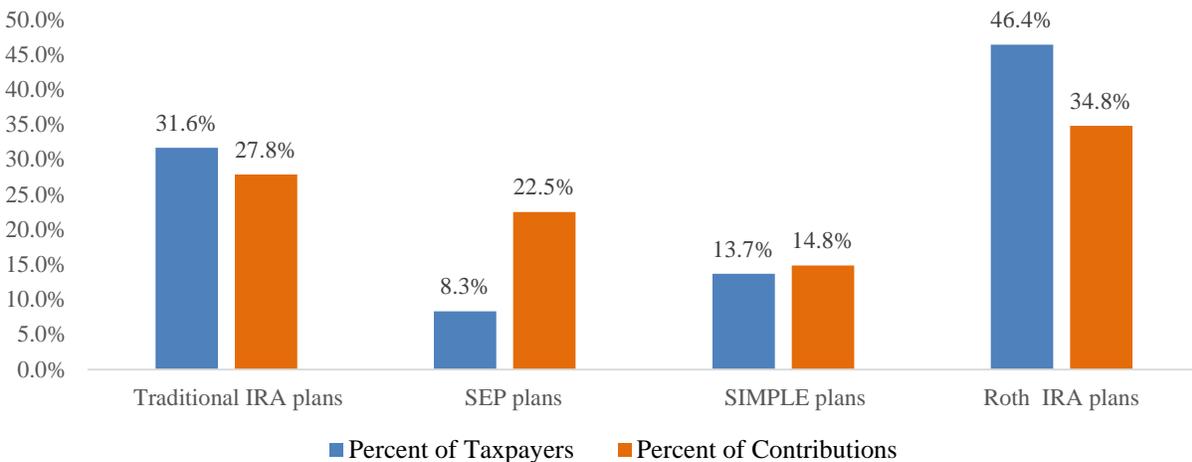
previously, individuals may make (1) direct contributions (annual) to an IRA or (2) rollover contributions from a qualified plan (when terminating participation in that plan).

The direct contributions may be made to a traditional IRA, Roth IRA, SEP-IRA, or SIMPLE-IRA. In each case, the account may represent an individual or small business person. In some cases, the direct contribution accounts tended to result in lower account balances, because the annual contribution limits for IRAs were historically lower than contribution limits for qualified defined contribution accounts. Further, individual or small business investors often open multiple IRA accounts over their retirement savings horizon, creating multiple small accounts.⁴⁸

Direct Contribution IRAs – Direct IRA contributions (distinguished from rollover contributions) totaled over \$50.7 billion in 2012. Graph 1 distributes these direct contributions by type of IRA account, Traditional, SEP, SIMPLE, or Roth IRA. As shown in the graph, the vast majority (65.2 percent) of direct contributions are made to IRAs that offer a current deduction (Traditional, SEP, and SIMPLE). However, nearly half of taxpayers (46.4 percent) making a direct contribution to IRAs are making contributions to Roth IRA plans.

Graph 1 Taxpayers Making Contributions to Individual Retirement Arrangements and Total Contributions, by Type of Account, Tax Year 2012

Source: IRS, SOI, Taxpayers with IRA Contributions, Table 3



One of the issues facing account holders with assets held outside of a qualified plan is access to information. Research indicates that paid financial advisers favor account holders with higher net worth and account balances (over certain thresholds).⁴⁹ For the adviser or broker-dealer, the cost of providing advice to small accounts would exceed the return for their efforts (based on a percentage of account balances). Average IRA account balances tend to be quite low for

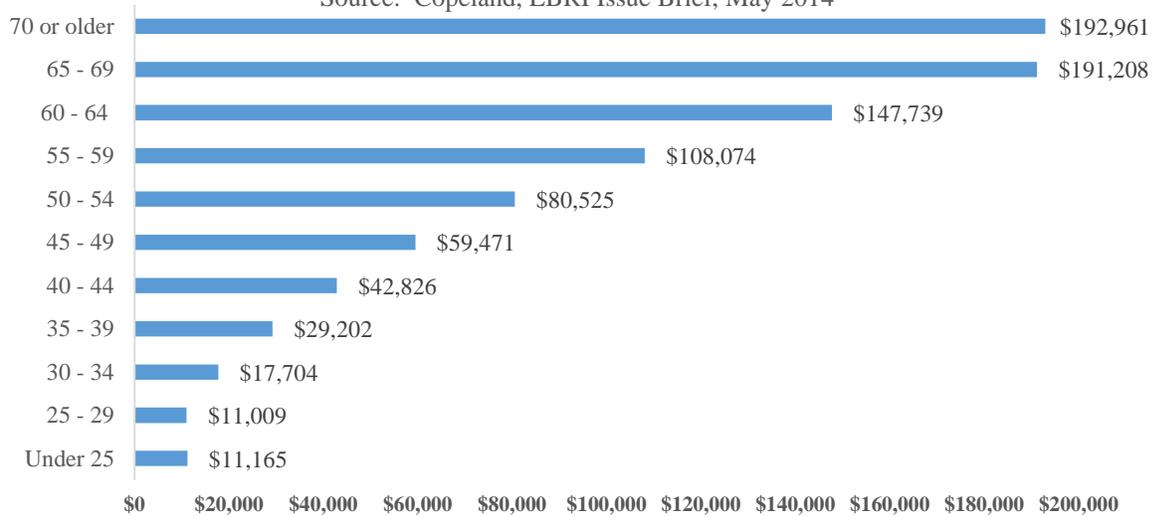
⁴⁸ While the account holders may rollover these multiple accounts to a single IRA account, empirical evidence suggests that this practice does not occur. Rollovers typically flow from qualified plans to IRAs. Refer to the EBRI Issue Brief, No. 399, *Individual Retirement Account Balances, Contributions, and Rollovers, 2012; With Longitudinal Results, 2010-2012: The EBRI IRA Database*, by Craig Copeland, May 2014.

⁴⁹ Refer to West, Jason, *Financial Advisor Participation Rates and Low Net Worth Investors*, Journal of Financial Services Marketing, Vol. 17, 1, February 2012.

younger and lower-income individuals. As shown in Graph 2, the individuals under age 40 have relatively low average account balances (less than \$30,000).

Graph 2 Average Individual IRA Balances, by Age of Account Holder, 2012

Source: Copeland, EBRI Issue Brief, May 2014



A recent study by Oliver Wyman of IRA account holders indicates that 51 percent of all IRA account holders had account balances less than \$25,000.⁵⁰ They also reported that the small account balances were pervasive across age groups.⁵¹ So, while younger IRA holders are more likely to have small account balances, as they begin their retirement savings, there are a large percentage of older IRA holders with small balances. The balance of nearly 23 percent of IRA accounts totals less than \$5,000, whereas 9.4 percent of IRA accounts total \$250,000 or more in assets (see Table 1).

Table 1.—Distribution of IRA Ownership, by Account Balance Size, 2013

Account Balance	Percentage of IRAs	Number of Accounts (in millions)
Less than \$5,000	22.7%	5.86
\$5,000 - \$9,999	10.4	2.68
\$10,000 - \$24,999	16.6	4.28
\$25,000 - \$49,999	14.2	3.66
\$50,000 - \$99,999	13.6	3.51
\$100,000 - \$149,999	6.7	1.73
\$150,000 - \$249,999	6.5	1.68
\$250,000 or more	9.4	2.43

Source: Copeland, Craig. *Individual Retirement Account Balances, Contributions, and Rollovers, 2013; With Longitudinal Results 2010-2013: The EBRI IRA Database*. Employee Benefits Research Institute, Issue Brief No. 414, May 2015.

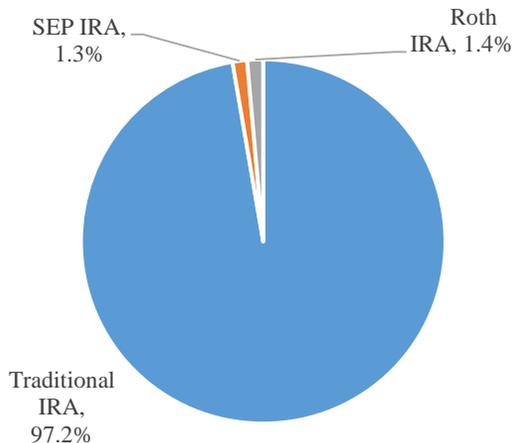
⁵⁰ Refer to Oliver Wyman, page 10.

⁵¹ *Ibid.*

In mid-2014, 71 percent of traditional IRA households indicated that they had a strategy for managing income and assets in retirement.⁵² Of these households, 66 percent had consulted with a professional financial adviser when creating this strategy and 58 percent indicated that the professional financial adviser represented their primary source for creating a retirement strategy.⁵³

Graph 3 Rollover Contributions to IRAs, Distributed by Type of IRA Plan, 2012

Source: IRS, SOI, Taxpayers with Individual IRA Plans, 2012, Table 2



Rollover Contributions – Rollover contributions to IRAs totaled over \$309.4 billion in 2012, an amount that is six times that of direct IRA contributions. One reason for this differential is the historical discrepancy between contribution limits for IRAs compared to qualified plans. Qualified plan participants generally may contribute a higher amount to their plan and, in many cases, receive employer matching amounts (a feature not available to Traditional IRA account holders). In addition, nearly all individuals making rollovers to IRAs do so to Traditional IRA plans (which preserves the favorable tax treatment of the qualified plan contributions).

The IRS SOI reports that approximately 4.1 million taxpayers made rollover contributions to an IRA plan in 2012, with rollover contributions to Traditional plans the most common (3.9 million taxpayers, representing 97.2 percent of the contributions and 95.3 percent of taxpayers reporting a rollover).

Given the pace of rollover activity (representing approximately 6 percent of the 65.8 million taxpayers reporting pension coverage on Form W-2), there is clearly a market for financial advice, as well as financial education. DOL argues that rollovers are driven by financial advisers and that participants would leave their assets with the former employer if they did not receive encouragement by financial advisers or call centers. The data on the large number of rollovers exceeds the assistance provided to terminating employees. Therefore the data do not support DOL’s premise.

1. Effects on IRA Account Holders

The re-proposed regulations would have a negative effect on IRA account holders, including the overall reduction in available advice (and/or advisers), asymmetrical fee disclosures that could confuse investors, and small investors being unable to obtain adequate financial information.

⁵² ICI Research Perspective, *supra*.

⁵³ *Ibid*.

Under the re-proposed regulation, many IRA investors could be expected to lose access to an investment professional through a brokerage relationship. The Oliver Wyman study related to the 2010 proposed regulation, but their analysis continues to apply to the re-proposed regulation. If individuals lose access to brokerage accounts under the re-proposed regulations, Oliver Wyman estimated that, based on account minimums for advisory accounts and IRA data available in 2011, 7.2 million IRAs would not qualify for financial assistance through an advisory account, solely within the sample size (which was 40% of the IRA market). In addition, small IRA investors would lose access to financial advisers for assistance in opening an account, making it less likely that these individuals will open an IRA.

Oliver Wyman estimated that the loss of access to brokerage accounts could result in lost retirement savings of \$96 billion over the 2010 – 2030 period, attributable to the loss of 3.8 million IRA accounts. This estimate used conservative assumptions of existing IRAs, assuming that (1) 60 percent of the 7 million accounts that would be below minimum account levels for an advisory account at any firm would migrate to a “low support” brokerage account, (2) 75 percent of the 4 million accounts that would be below their firm’s minimum asset level for an advisory account but would qualify for such an account at another firm would move to another firm’s advisory account IRA, and (3) 100 percent of the nearly 12 million accounts that met the minimum for their firm’s advisory account would stay with that firm and migrate to an advisory account. Oliver Wyman also estimated that, over the 2010 – 2030 period, an additional 8.5 million IRA accounts that would have been established under current law would not be established.

Availability of Investment Advice/Advisers – Garber et al. (2015) looked only at IRA investors and qualitatively analyzed the effects of the 2010 regulations on sophisticated and unsophisticated IRA investors.⁵⁴ The authors do not measure these effects, but conclude that unsophisticated IRA investors who forego investment advice could have lower rates of return and decreases in IRA contributions because coaching helps these investors make the right retirement savings decisions.

Garber et al. indicates that availability of investment advisers serving the IRA market may well decline after the re-proposed regulations take effect. They state

“The number of professional advisers needed to serve the IRA market would be expected to decrease as a result of adopting the rule to the extent that broker-dealers exit the IRA market or take steps to reduce their IRA-related advisory activities.”⁵⁵

Small Account Holders – Individuals with small account balances would not be able to obtain paid (based on a percentage of assets) investment advice. The Oliver Wyman study confirms this, reporting that investors represented in their study group overwhelmingly use the brokerage relationship model as opposed to a fee-based advisory model, with 22.4 million or 88

⁵⁴ See Garber et al. (2015), *supra*, Table 5.1 at p. 27. Garber et al. evaluate the 2010 regulations in terms of the effects on IRA investors with respect to (1) total advisory fees, (2) rate of return on IRA portfolio, (3) time spent by investor, and (4) IRA contributions.

⁵⁵ Garber et al., Page 18.

percent of IRA accounts holding brokerage IRAs.⁵⁶ The prevalence of these arrangements increased to 99 percent for accounts with less than \$10,000.⁵⁷

Since the brokerage account fee arrangements violate the re-proposed regulations with respect to IRA investors, advisers will shift to advisory accounts or require larger minimum account balances. Garber et al. found that

“We have no empirically grounded basis for predicting whether minimum account balances would increase if the Proposed Rule were implemented. Within our conceptual framework, however, minimum account balances would increase if . . . broker-dealers would be unable to create a set of service offerings that could be purchased by IRA investors at fee levels that could cover broker-dealers’ costs, while retaining the minimum account balances that exist under the status quo.”⁵⁸

The fixed costs associated with all retirement plans (e.g. research, investment, or administrative costs) indicate that small account balances require comparable effort and input as an account with larger account balance. Therefore, broker-dealers and advisers would be unable to charge fees sufficient to cover their costs, and this would reduce the availability or intensity of investment advice for IRA account holders.

B. Small Business Retirement Plans

Small businesses historically adopt retirement plans at significantly lower rates than employers of any other size. The latest Bureau of Labor Statistics (BLS) survey of employee benefits in the United States found that, in March 2014, 45 percent of small businesses with 1-49 employees offered retirement plans, compared to 63 percent of employers with 50 to 99 workers, 78 percent of employers with 100-499 employees, and 89 percent of employers with 500 workers or more.⁵⁹

At the same time, small businesses represent a primary driver of the U.S. economy. Small businesses account for approximately half of the nation’s employment and small businesses drive job growth in the United States. According to the BLS Business Employment Dynamics data, for the third quarter of 2014, small businesses accounted for 59.2 percent of net increases in jobs.⁶⁰

⁵⁶ The IRS SOI data indicate that there were over 55 million IRA accounts in 2012. This study provides a significant representation of IRA account holders.

⁵⁷ *Ibid.*

⁵⁸ Garber et al, Page 17.

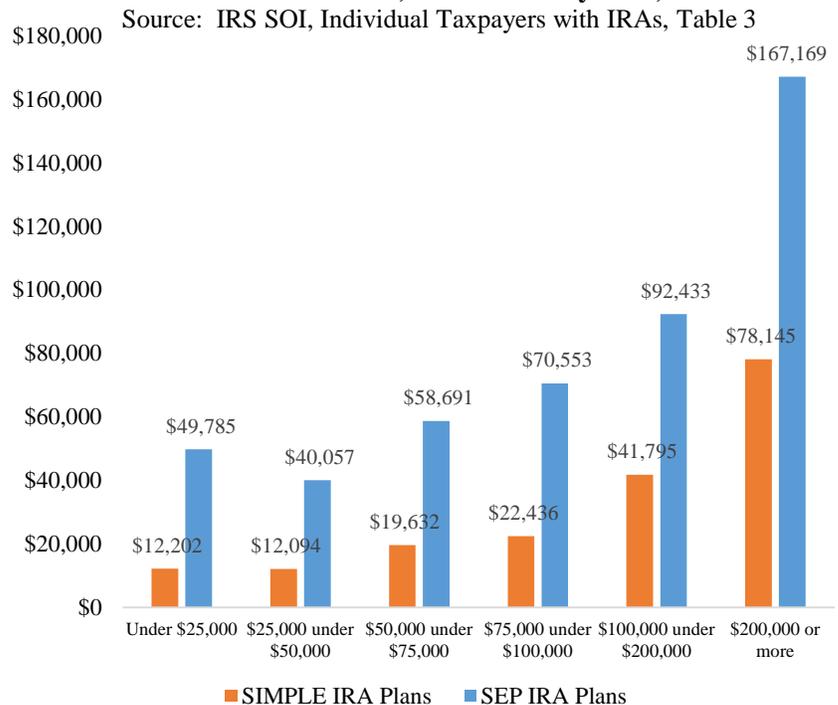
⁵⁹ United States Department of Labor, Bureau of Labor Statistics, *Employee Benefits in the United States – March 2014*, USDL-14-1348, July 25, 2014. BLS reports the data by establishment size, which is defined as the physical location of a specific economic activity. A single firm could be represented by multiple establishments.

⁶⁰ United States Department of Labor, Bureau of Labor Statistics, Business Employment Dynamics, *Table B. Firm size percentage share of gross job gains and losses, third quarter 2014, seasonally adjusted.*

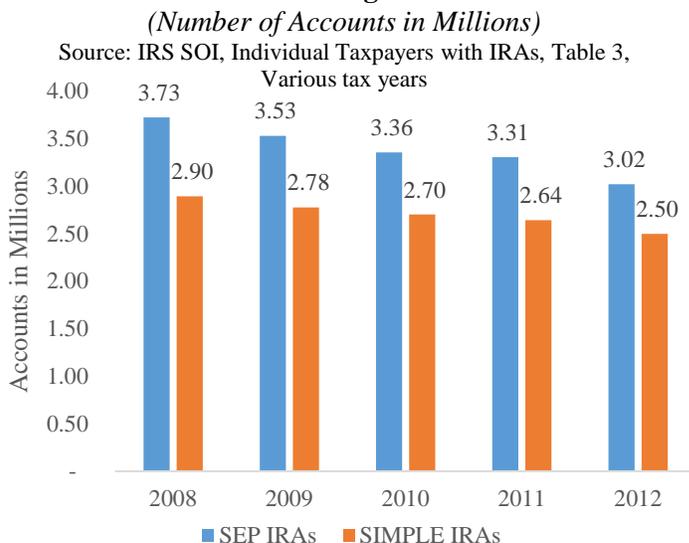
Low adoption rates coupled with high job creation rates have led many government and private sector organizations, including the DOL, to undertake efforts to increase the number of small businesses adopting retirement plans for their employees. The re-proposed regulations make it more difficult for broker-dealers to (1) service existing small business plans and (2) market new plans to small employers.

SEP and SIMPLE IRAs – There were more than 20 million small businesses in the United States in 2012. However, there were only about 6 million SEP and SIMPLE IRA plans. As with other IRAs, these small business IRA-based

Graph 4 Average Fair-Market Value of SEP and SIMPLE IRA Plans, Distributed by AGI, 2012



Graph 5 Decline in SEP and SIMPLE IRAs, 2008 through 2012



plans tend to be smaller with lower account balances. Recent data from the IRS SOI indicate that lower-income taxpayers with SEP and SIMPLE IRAs tend to have considerably lower average account balances compared to those taxpayers with higher incomes. This is particularly true for taxpayers with less than \$100,000 in adjusted gross incomes who have a SIMPLE IRA plan. These accounts average less than \$25,000, an average account balance that is a third of the account balance of taxpayers in the highest income class.

SEP IRA owners have a similar pattern, with higher average account balances, but taxpayers with less than \$75,000 of adjusted gross incomes with a SEP IRA have an average account balance that is a third of that for taxpayers in the highest income class.⁶¹

⁶¹ One possible explanation for the higher account balances is that the IRS SOI data indicate that SEP IRAs accept rollover amounts, while SIMPLE IRAs do not. Given the higher level of rollover amounts compared to contribution amounts, this would explain the higher account balances.

The number of SEP and SIMPLE IRAs has continued to decline in recent years. Since 2008, the number of SEP IRAs declined from 3.73 to 3.02 million and the number of SIMPLE IRAs declined from 2.90 to 2.50 million accounts. (Refer to Graph 5.)

Evidence of Small Business Retirement Plans – Small business retirement plans present characteristics consistent with the overall situation that IRA-based small business plans face. As employer size increases, the likelihood of a qualified retirement plan also increases. Put another way, small businesses offer plans at nearly half the rate of larger employers. According to the Bureau of Labor Statistics, 2014 National Compensation Survey, only 44 percent of employees of small businesses (fewer than 100 employees) have access to a retirement plan compared to 89 percent of employees of large businesses (500 or more employees). The Census Bureau indicates that 40.2 million employees of small businesses (defined as an employer with fewer than 100 employees) worked for employers that did not offer a plan. The majority of these employees work for employers with fewer than 50 employees (34.4 million employees).⁶²

The low percentages for small businesses offering retirement plans can be attributed to both the focus of small business owners and the costs of adopting and maintaining these plans. A recent CNBC/Financial Planning Association (FPA) survey found that small business owners overall invest 70 percent of their wealth in their business.⁶³ Developing a retirement plan and exit strategy represents the most pressing financial challenge facing small business owners (reported by 42 percent of the survey sample).

Another survey, conducted by TD Bank, found that only about one quarter of small business owners are confident they will have enough money to retire comfortably.⁶⁴ Financial advisers identified three key initiatives that could help small business owners.⁶⁵ Of these, reducing dependence on the sale of a business to fund retirement by diversifying savings (e.g., adopting a retirement plan) represented the number one initiative.⁶⁶

The retirement savings of small company workers correlates directly with the lower rates of retirement plans by small businesses. A Transamerica Center for Retirement Studies survey found that, in 2013, the estimated median household retirement savings for Baby Boomers, who were closest to retirement, working for small companies (\$92,000) lagged the median retirement savings for Baby Boomers working for large companies (\$113,000) by \$21,000.⁶⁷ When asked what would motivate workers to learn more about saving and investing for retirement, workers of all companies indicated that educational materials and a financial adviser were significant

⁶² Refer to EBRI, Issue Brief No. 392, *Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2012*, Craig Copeland, November 2014.

⁶³ Loannau, Lori. *Small-biz owners don't save enough for retirement: CNBC/FPA poll*, CNBC, August 19, 2014. Accessed at <http://www.cnbc.com/id/101903945>.

⁶⁴ *New Survey Finds Small Business Owners Uncertain About Retirement Plan, Finances*, May 4, 2015. Accessed at <http://www.prnewswire.com/news-releases/new-survey-finds-small-business-owners-uncertain-about-retirement-plan-finances-300076411.html>.

⁶⁵ CNBC/FPA survey, *supra*.

⁶⁶ If small business owners neglect their own retirement planning, their employees also lose the benefits of an employer-sponsored retirement savings plan, making it much less likely that these employees will save adequately for retirement. For this reason, the Department of Labor and other government and private sector organizations conduct outreach programs to encourage the adoption of retirement savings plans by small business owners.

⁶⁷ *The Retirement Readiness Imperative: Overcoming the Challenges Faced by Small Companies, 14th Annual Transamerica Retirement Survey*. Transamerica Center for Retirement Studies, October 2013.

motivators. In fact, the majority of small company workers (56 percent) prefer more information and advice on how to reach their retirement goals.⁶⁸

A recent survey found that a substantial percent (67 percent) of small businesses that do have retirement plans rely on a financial adviser or record-keeper to assist in investment selection and monitoring (Greenwald & Associates survey).⁶⁹ Especially in the case of smaller companies (10-49 employees), a financial adviser plays an important role in assisting with the retirement plan. Contrast this with the fact that a relatively small percentage of small business owners (less than one-third) have worked with an adviser on a business plan, suggesting that financial advisers play key roles in the establishment of retirement savings plans by small businesses.⁷⁰ Thus, if the re-proposed regulations reduce availability of financial advisers for small businesses with respect to retirement savings issues, then a corresponding reduction in both the number of small businesses offering retirement plans to their employees and a reduction in total retirement savings could be expected.

The Greenwald & Associates survey supports this conclusion. The survey examined small business owner reactions to the anticipated re-proposed regulations and found that:

- Almost 30 percent of small businesses with a retirement savings plan indicated that it was at least somewhat likely they would drop their plan;
- Almost 50 percent with a retirement savings plan indicated they would be at least somewhat likely to reduce their matching contributions, offer fewer investment options, and increase fees charged to plan participants; and
- Close to 50 percent of small businesses without a retirement savings plan would be less likely to adopt a plan, with 36 percent saying the re-proposed regulation would reduce this likelihood greatly.

The re-proposed regulations pose two difficulties for small businesses. First, while small employers may represent an area of market growth for creating new plans (and building the assets associated with that plan), the re-proposed regulations make marketing to these small businesses nearly impossible (because neither the best interest contract exemption nor the seller's exception applies). This means that broker-dealers cannot continue to pursue this line of business without violating the prohibited transaction rules. Eliminating marketing to small businesses will result in a decline in small business retirement plans.

The other potential effect is that, like small account IRAs, broker-dealers are likely to reduce the overall effort for investment information and advice for small business plans (that are more likely to have small account balances) so that it is commensurate with the return on the plan. Relative to a larger business's plan, this suggests a significantly restricted level of service.⁷¹

⁶⁸ *Ibid.*

⁶⁹ *The Impact of the Upcoming Re-Proposed Department of Labor Fiduciary Regulation on Small Business Retirement Plan Coverage and Benefits*, Greenwald & Associates, May 14, 2014.

⁷⁰ CNBC/FPA survey, *supra*.

⁷¹ Recent data analysis by the Small Business Administration indicates that business owner characteristics are changing to reflect the changing demographics of the United States. Specifically, the percentage of minority and Hispanic business owners is increasing significantly. Refer to Lichtenstein, Jules, *Demographic Characteristics of Business Owners*, Small Business Administration, Office of Advocacy, Issue Brief, Number 2, January 2014.

C. Availability of Advisory Materials to Plan Participants

The DOL re-proposed regulations would create unintended consequences with respect to all retirement plan participants because the regulations both prevent meaningful educational materials from being provided and prohibit any financial advice with respect to plan distributions and rollovers. Data indicate that participants receiving advice and education tend to have higher deferral rates, take full advantage of the employer match, and have greater portfolio diversity. Further, when a participant terminates employment, the receipt of some form of advice and educational materials increases the incentives to preserve retirement savings, either by rolling over to an IRA or by retaining the assets in the employer plan.

1. Current Plan Participants

Retirement plans make available educational information to improve financial literacy as well as investment advice to improve the performance of their employees' retirement plans including:

- choosing a financial adviser and the degree of services offered to employees;
- creating savings behaviors and improving financial literacy; and
- creating behavior that continues through employment and beyond (e.g., rollovers to another plan or an IRA upon job termination).

Evidence indicates that plan participants that seek help (defined in a variety of ways, including advice from investment advisers and broker-dealers) tend to have better saving habits and performance. A recent study by World at Work and the American Benefits Institute confirms that the majority of plan sponsors provide investment advice services – defined as professional recommendations or guidance to help participants accumulate and manage their retirement savings. For example, the study found that 53 percent of plan sponsors surveyed provided such professional services (increasing nearly 40 percent since 2008).⁷²

Deferral Rates – The Financial Engines/AON Hewitt report shows that people using managed accounts and online advice have higher average contribution levels than other participants.⁷³

⁷² WorldatWork and American Benefits Institute, *Trends in 401(k) Plans*, March 2013.

⁷³ Refer to Aon Hewitt, *Help in Defined Contribution Plans, 2006 through 2012, 2013*.

Table 2.—Characteristics of Participants, Classified by Type of Financial Advice			
	Managed Accounts	Online Advice	Non-Help
Average Age	48	45	46
Average Balance	\$93,361	\$155,599	\$78,713
Average Salary	\$64,121	\$91,923	\$58,842
Average Contribution	7.5%	9.0%	6.6%
Source: Aon Hewitt, <i>Help in Defined Contribution Plans, 2006 through 2012</i>			

Deferral rates for those using managed accounts or online advice were considerably higher than the rates for those not receiving help.

The managed account feature and online financial advice described in the Aon Hewitt study is consistent with the findings of a recent Vanguard report. Vanguard reports that 35 percent of plans use online advice (covering 69 percent of participants); and 19 percent of plans used professionally managed allocations (covering 52 percent of participants). In addition, Vanguard reports that 68 percent of plan offered financial planning services (covering 74 percent of participants).⁷⁴ They find that many of their participants lack the financial planning skills, time or interest to make appropriate investment decisions.⁷⁵

Employer Matching – More than half of all employers offer their employees the ability to defer current wages and salary into a defined contribution retirement account (often a 401(k) plan).⁷⁶ These accounts typically offer an employer matching contribution in addition to the employee deferrals. In 2011, employees contributed approximately \$186 billion and employers provided matching contributions of an additional \$122 billion.⁷⁷

A recent study by Financial Engines Advisory Services estimated that nationwide defined contribution plan participants are not saving enough to receive their full employer matching contributions. They estimated that this amount total approximately \$24 billion annually.⁷⁸ However, the study finds that participants that use financial advisory services (including both active users of online advice and professional management services) were more likely to maximize their matching contributions. The Financial Engines survey found that only 15 percent of participants who used advisory services did not save enough to claim the full employer match

⁷⁴ Refer to Vanguard, *How American Saves, Managing Participant Accounts*, page 56, 2014.

⁷⁵ According to the Vanguard report, plan sponsors using Vanguard as their record keeper use a range of advice services, including online advice, Personal Online Advisor, managed account advisory, Vanguard Managed Account Program, and Vanguard Financial Planning Services.

⁷⁶ Refer to Copeland, Craig, Ph.D., *Retirement Plan Participation: Survey of Income and Program Participation (SIPP) Data, 2012*, Employee Benefits Research Institute. The study indicates that, based on the latest Survey of Income and Program Participation data from the U.S. Census Bureau, 61 percent of all workers over age 16 had an employer that sponsored a pension or retirement plan for any of its employees in 2012. The percentage of workers participating in a plan was 46 percent in 2012.

⁷⁷ U.S. Department of Labor, Employee Benefit Security Administration, Private Pension Plan Bulletin, *Abstract of 2011 Form 5500 Annual Reports*, June 2013.

⁷⁸ Refer to Financial Engines, *Missing out: How much employer 401(k) matching contributions do employees leave on the table?* May 2015. The estimate relies on study data of over 1 million plan participants that did not claim over \$1.2 billion in employer matching contributions.

compared to 26 percent of those who did not use any advisory services. The effects of financial advisory services were most pronounced for lower income participants. For the lowest income participants (\$20,000 of income or less), only 18 percent of those who used advisory services did not claim the match compared to 48 percent of those who did not use any advisory services.⁷⁹

Portfolio Diversity – Another behavior associated with improved retirement plan performance is portfolio diversity, including the move away from employer stock as a primary investment.⁸⁰ Studies highlight the importance of investment diversification; however, participants often lack the financial literacy to select the best allocation for investing their savings.

One important service offered by investment advisers and broker-dealers is the ability to diversify portfolios to reflect the level of risk that is comfortable to the participant. Recent survey data indicate that participants are moving away from employer stock. In 2003, 23 percent invested less than 5 percent in company stock, while 35 percent of plan participants invested 20 percent or more of their retirement savings in employer stock. In 2012, the trend away from employer stock was evident, with 81 percent of participants investing 5 percent or less in employer stock and only 7 percent investing 20 percent or more in employer stock.

In its 2011 regulations, the DOL stated that “quality advice will address over concentration in employer stock and other failures to properly diversify.”⁸¹ With the increases in advisory services, the average number of funds available to plan participants has increased substantially, with 91 percent of plan sponsors surveyed in the World at Work and American Benefits Institute survey responding that they offer 11 or more investment choices to their plan participants.⁸²

One of the unintended consequences of the re-proposed regulations is that advisory services could be expected to decline, as broker-dealers and financial advisers attempt to navigate the conflict of interest and prohibited transactions rules. In 2011, the DOL estimated that financial advice could increase retirement savings by more than \$29 billion each year.⁸³ Based on their analysis, the converse also holds – loss of financial advice could reduce retirement savings for active participants.

2. Terminating Plan Participants

A lack of financial sophistication can be expected to cause a worker to make bad decisions at critical points in his or her working life when savings behavior may change. One of the critical points in the retirement savings process occurs when an employee changes jobs or retires; at this point, an individual must decide what to do with retirement savings accumulated in a former

⁷⁹ *Ibid.* Differences between participants using advisory service and those that do not continued for individuals with income up to \$120,000. After that point, the differences remained, but were not as pronounced.

⁸⁰ Several well-known business failures highlighted the importance of investment diversity, as plan participants invested exclusively in the employer’s stock (e.g., Enron). Refer to Mitchell, Olivia, and Stephan Utkus, *The Role of Company Stock in Defined Contribution Plans*, National Bureau of Economic Research Working Paper W9250, October 2002 and Meulbroek, Lisa, *Company Stock in Pension Plans: How Costly is it?* Social Science Research Network, March 2002.

⁸¹ Federal Register, Volume 76, No. 206, Rules and Regulations, Tuesday, October 25, 2011, page 66154.

⁸² Refer to WorldatWork and American Benefits Institute, Trends in 401(k) Plans, March 2013.

⁸³ *Supra*, Federal Register, Volume 76.

employer's plan.⁸⁴ Pre-retirement cash outs represent one of the biggest risks to retirement savings and are estimated to total \$70 to \$104 billion per year.⁸⁵ A recent study estimated that nearly 25 percent of all taxpayers younger than age 55 with current pension coverage (or retirement balances from past contributions) had a gross distribution of retirement savings in 2010.⁸⁶

A risk to long-term retirement readiness is the potential for pre-retirement cash outs of retirement savings. According to a 2011 survey, 42 percent of employees take a cash distribution of their retirement savings at job termination, 29 percent roll their retirement savings to another retirement plan or an IRA, and 29 percent leave their assets in the employer's plan.⁸⁷ Cash-outs are highest among individuals who are younger, have lower wages, and have less tenure with an employer. Higher cash-out rates are also an issue for African-Americans and Hispanics.

Assistance provided by call centers and broker-dealers at job termination plays a key role in reducing cash-out rates, particularly among these groups who are least likely to use the services of a paid financial planner.⁸⁸ As a result, reducing access to call center and broker-dealer assistance will likely disproportionately affect the individuals who are most vulnerable to cash outs.

Individuals who have access to financial assistance are less likely to lose track of their retirement savings and more likely to make informed decisions about what to do with their retirement savings when they terminate employment. Individuals who make informed decisions are (1) less likely to lose track of retirement savings left in a former employer's plan and (2) less likely to cash out their retirement savings.

The re-proposed regulations will prevent financial advisers either directly or through other forms of contact (such as online assistance or call in centers) from providing assistance to employees who are terminating employment with respect to their retirement savings. This occurs because the best interest contract prohibited transaction exemption does not apply to distributions and rollovers (and is unworkable even if it were to be made applicable). In effect, the DOL re-proposed regulations will leave terminating employees without a form of assistance and will likely lead to increased cash outs of retirement savings or the potential for another lost retirement savings account.

⁸⁴ One of the advantages of a defined contribution plan is that it provides portability for employees upon job change. An employee who terminates employment typically has several options with respect to his or her accumulated retirement savings; the individual can: leave the retirement savings in the old employer's plan; transfer or roll over their retirement savings to a new employer's plan or an IRA; or withdraw the accumulated retirement savings and use them for nonretirement purposes.

⁸⁵ Fellowes, Matt and Katy Willemin, *The Retirement Breach in Defined Contributions Plans. Size, Causes, and Solutions*, HelloWallet, January 2013, and Argento, Robert, Victoria L. Bryant, and John Sabelhaus, *Early Withdrawals from Retirement Accounts During the Great Recession*, prepared for presentation at the November, 2012 National Tax Association annual meetings, November 2012.

⁸⁶ Argento et al, *supra*.

⁸⁷ *Leakage of Participants' DC Assets: How Loans, Withdrawals, and Cashouts Are Eroding Retirement Income 2011*, AON Hewitt, 2011.

⁸⁸ One financial services company indicated that oral communications with employees terminating employment has a significant effect on cash-out rates; employees with account balances between \$35,000 and \$50,000 are approximately 3.2 times less likely to cash out their retirement savings if they receive a call rather than only receiving written communications.

D. Cumulative Loss in Retirement Savings and Reductions in Retirement Readiness

1. Loss in Retirement Savings

Estimated effects of the re-proposed regulations on retirement savings must identify the (1) types of plans most likely to have reduced investment and financial advice (IRAs and qualified plans); (2) within those plans, the participants who would seek paid advice (if reductions in investment and financial advice occurs); and (3) size of the plan (small business plans and low-balance plans and accounts).

Conservative estimates of the combined reduction in retirement assets attributable to the unintended consequences of the re-proposed regulations suggest that the regulations could be expected to result in losses of retirement savings of \$68-\$80 billion each year.

This total includes the reductions in assets associated with an overall lower level of investment services; assets not retained in or rolled over to a retirement plan or IRA; and loss of positive saving habits and behaviors associated with advisory services.⁸⁹ Because of the overlapping effects of the various components of the estimate, providing separate estimates for each component would provide an inaccurate picture of the potential losses. The analysis does consider these potential overlapping effects; for example, reduced contributions to retirement plans will lower the level of retirement savings that might be cashed out under the regulations. Thus, the estimates of the various components have many interactive effects that must be incorporated to provide a more realistic estimate of the total effects.

The analysis also considers the reduction in the positive behavioral effects of investment and financial advice on deferral rates, matching contributions, and plan diversification. Reductions in financial advice could occur as current participant behavior transitions to pre-financial advice practices. Finally, the analysis considers the effect on terminating participants if advice becomes unavailable.

Loss in Retirement Savings – Three components comprise the total reductions in retirement savings attributable to the re-proposed regulations. First, IRA owners and qualified plan participants could be expected to respond generally to the reduction in investment advice (overall reduction in financial advice and the intensity of such advice) by changing their retirement savings behavior. This reduction includes investment guidance to IRA owners that would violate the conflict of interest rules as well as educational information made available to plan participants to guide their investment selections.⁹⁰ Second, increased cash outs can be expected

⁸⁹ Refer to Appendix A for a detailed description of each component of the estimate.

⁹⁰ IRA owners and qualified plan participants have a degree of overlap, as many contributions held in IRAs were originally contributed to a qualified plan. The analysis attempts to eliminate the potential for double-counting or overstating the reduction in retirement assets due to the reduction in financial advice.

to occur as retirement plan participants terminating employment (and IRA owners) lose access to assistance that will help them keep their assets in retirement savings. Finally, in response to reduced financial advice, fewer small business owners will establish and maintain retirement plans for their employees.

The components of each of these estimates rely on several steps.

Response to reduced availability of financial advice for IRA owners and retirement plan participants – First, with respect to the estimates of the response of IRA owners and retirement plan participants to a reduction in the overall availability of financial advice, the analysis constructs a distribution of IRA owners (including small business plans) and qualified plan participants with their associated contribution patterns and average account balances.⁹¹ The analysis creates baseline estimates of the availability and use of financial assistance by IRA owners and plan participants, using data from the 2013 Survey of Consumer Finances as well as academic research of this use.⁹² This provides a basis to simulate the expected utilization of advice and/or reduced access to such advice. Finally, the analysis estimates the aggregate changes in the following: (1) decreased contribution rates; (2) increased investment errors (e.g. inadequate diversification, excessive or inadequate risk); and (3) reductions in matching contributions (pertaining to qualified plan participants only).⁹³ Collectively, these effects are assumed to reduce contribution levels as well as reduce overall account balances.⁹⁴

Increased cash outs for plan participants terminating employment and IRA owners – Plan participants terminating employment could be expected to increase withdrawals from qualified plans, reducing the total assets held in retirement accounts. Based on previous empirical work, there is a relationship between financial advice and retaining assets in a qualified retirement account. The estimates of increased cash-outs of retirement savings and reduced rollovers to IRAs and other qualified plans rely on a number of data sources as well as our estimates of the effect of call centers and/or broker-dealer assistance on these cash outs.

The first step in estimating the potential increases in cash-outs from retirement assets and reduced rollovers to IRAs and other qualified plans requires estimating pension participation by income class. This analysis relies on Internal Revenue Service (IRS) Statistics of Income (SOI) tabulations of the elective deferrals claimed on taxpayers' Form W-2 for 2010.⁹⁵ Table 3 displays the number of taxpayers with elective deferrals and the aggregate amount of the deferral.

⁹¹ Data for this analysis relies on IRS SOI data for IRA owners as well as EBRI analysis of their IRA data base.

⁹² Refer to Leonard-Chamber, Victoria and Michael Bogdan, *Why do Mutual Fund Investors Use Professional Advisers?*, Investment Company Institute Research Fundamentals, 2007.

⁹³ These parameters for these changes follow the methodology used by the Treasury Department in their analysis of the increased savings associated with advice and investment assistance from investment professionals. Refer to the Federal Register, Vol. 76, No. 206, October 25, 2011.

⁹⁴ This estimate also accounts for the potential for the regulations to drive some people out of the IRA market because they won't be able to use the brokerage model and their account balances are too small to use the advisory model.

⁹⁵ The IRS tabulation of W-2 data includes elective deferrals from all employer-provided defined contribution amounts for primary and/or secondary taxpayers. Elective retirement contributions are reported on the Form W-2, box 12 and includes the following codes: code D (traditional 401k), code E (traditional 403b), code F (SEP), code G (457b), code H (501(c)(18)(D)), code S (SIMPLE), code AA (Roth 401k), and code BB (Roth 403b).

The second step is to impute aggregate balances for the distribution of taxpayers reporting retirement contributions on Form W-2. This information relies on several surveys. Using multiple data sources provided an opportunity to verify and corroborate the assumptions applied to the taxpayer characteristics.⁹⁶ The third step is to estimate the qualified plan participants who may experience a break in service (through job termination) and face a decision regarding plan assets held with their previous employer. The Job Opening and Labor Turnover Survey (JOLTS) from the Bureau of Labor Statistics estimated that 37.1 percent of current workers experience separation from employment during the year. The definition of separation includes voluntarily quitting, being laid off, or being fired.⁹⁷

From this information, we derive estimates of the potential retirement savings balances that are likely to become vulnerable to cash out.⁹⁸ We assume that those employees cashing out balances currently will continue to do so. With respect to employees choosing to leave account balances in a former employer's plan passively (through inaction), we assume that the small number of account balances that would have remained passively with the former employer will also be likely to remain there.

The next step involves investigating the role of call center and broker-dealer assistance in helping workers retain their retirement savings at job change. Our research relies on a DOL-sponsored pilot survey that looks at how current enrollees in employer-sponsored defined contribution (DC) plans make retirement decisions.⁹⁹ Our empirical models suggest that retirement savings plan balances are 33 percent higher if a financial planner or broker was consulted for financial advice. Our parameter estimates support our theory that consultations with call centers or brokers/dealers result in retirement savings in DC plans that are higher by about 33 percent. Our model suggests important life-cycle effects are present in retirement savings with plan balances increasing with age initially and then increasing at a decreasing rate as workers approach retirement age.¹⁰⁰

Reduced retirement account and retirement plan creation – Finally, the analysis estimates the reduced assets held in retirement accounts attributable to reduced account creation or reduced account contributions for small business plans.¹⁰¹ The first step in creating the estimated

⁹⁶ Refer to Appendix A for a detailed description of the data sources and the methodology.

⁹⁷ Refer to Hathaway, Kendra C., *Job openings continue to grow in 2012, hires and separations less somewhat*, JOLTS Annual Story, Monthly Labor Review, May 2013.

⁹⁸ In addition, the estimates include an adjustment for the likelihood that workers separating from employment have access to a qualified plan.

⁹⁹ The survey asked the following question: “How do you make decisions about savings and investment related to retirement?” The possible responses were: “1) Ask relatives/friends, 2) Talk to financial planners/brokers, 3) Talk to lawyers, 4) Read magazines/newspapers/books, 5) Get advice from television, and 6) Other.” Of the respondents who had not already retired, approximately 24 percent indicated that they had talked to financial planners/brokers. These contacts likely include both consultation with a paid financial planner and contacts through a call center or broker-dealer associated with their employer's retirement savings plan.

¹⁰⁰ Theoretically, the regulation could drive some people out of the IRA market because they won't be able to use the brokerage model and their account balances are too small to use the advisory model. However, this effect is difficult to quantify separately and the reduced account creation is incorporated in the first component.

¹⁰¹ A number of assumptions regarding the demographics and characteristics of IRA owners and qualified plan participants support these estimates. First, lower income individuals and account holders with small account balances are assumed to be most likely to respond to reduced advisory services. In addition, the analysis assumes

reduction is to create the distribution of small business plans, as well as future creation of small plans. Average contribution levels for small business plans rely on data from the IRS SOI (e.g. SEP and SIMPLE contributions) as well as recent survey data. While contributing a very small effect to the total reduction in retirement savings, this estimate includes two effects – a reduction to the contributions amounts (similar to that described for IRA owners and other plan participants) as well as the reduced creation of new small business plans.¹⁰²

2. Reductions in Retirement Readiness

As discussed previously, retirement readiness provides an important measure of whether individuals are saving enough for retirement. Under current law, many Americans face challenges in accumulating sufficient retirement assets to live comfortably in their retirement years. The fact that many individuals do not begin saving for retirement early enough, do not save enough, and access their retirement savings for non-retirement spending all contributes to the problem.

The re-proposed regulations would jeopardize retirement readiness for 11.9 million IRA and retirement participants. This 11.9 million figure consists of individuals who either are unlikely to be retirement ready (6.1 million) or are at risk of failing to be retirement ready (an additional 5.8 million).

This reduced retirement readiness would occur because the re-proposed regulations likely would result in increased pre-retirement cash outs of retirement savings, decreased contributions to retirement savings as individuals either reduce their contributions or do not begin saving for retirement, and decreased rates of return on retirement savings due to changes in investment portfolios.

The EBRI analysis of retirement readiness indicates that most individuals will fall short of meeting their retirement readiness goal (defined as 80 percent of preretirement income).¹⁰³ Incorporating the results of their simulation into this analysis of participants that will face reduced retirement readiness, we find that of these 11.9 million participants, **an estimated 6.1 million participants are already below that 80 percent goal and would fall materially below that number by reason of the DOL re-proposed regulations.**

that plan creation will decline among small businesses if dealer-brokers are unable to provide marketing services that run afoul of the re-proposed regulations. This effect is likely to be small, as new plan creation among small business tends to be low.

¹⁰² The level of creation for small business plans is relatively low. Therefore, this effect is likely to be relatively small. The effect of the reductions in the IRA market for small businesses is included in the first component.

¹⁰³ Refer to VanDerhei, Jack, *What Causes EBRI Retirement Readiness Ratings to Vary: Results from the 2014 Retirement Security Projection Model*, EBRI, Issue Brief No. 396, February 2014. EBRI estimates that 16.8 percent of the lowest-income; 52.6 percent of the second-income; and 71.7 percent of the third-income quartiles will fail to reach their retirement readiness goal of 80 percent of preretirement income. This estimate applies their estimates to the participants that are likely to face adverse effects of the DOL re-proposed regulations.

Collectively, these effects lower the trajectory of asset accumulation for retirement.¹⁰⁴ While there are a number of ways to measure retirement readiness, by any measure, changes to savings behavior that have the potential to decrease asset accumulation will result in the loss of retirement readiness.

VI. Conclusions

The re-proposed regulations would affect adversely the retirement savings of millions of Americans by reducing or eliminating access to financial advice. The adverse effects include (1) reduced contributions to retirement savings (due to reduced levels of contributions or the failure to be saving for retirement), (2) changes in investment portfolios that will result in increased risk or inappropriate diversification, (3) a decline in the number of small business retirement plans, and (4) increased pre-retirement cash outs of retirement savings.

These effects would result in an estimated reduction in retirement savings of \$68-\$80 billion per year and reduced retirement readiness for 11.9 million participants. In addition, an estimated 6.1 million of these individuals already were likely to fail to meet their retirement readiness goal, but would fall materially below that number by reason of the DOL re-proposed regulations.

¹⁰⁴ Refer to Quantria Strategies, LLC, *Access to Call Centers and Broker Dealers and Their Effects on Retirement Savings*, April 9, 2014, that finds that pre-retirement distributions could reduce final retirement account balances by 26 to 41 percent, making it difficult, if not impossible, for the individual to achieve retirement readiness

Appendix A: Detailed Methodology of Estimates

1. IRAs

Analysis of the potential cost of the re-proposed regulations on IRAs relies on data from the Internal Revenue Service Statistics of Income (SOI). The following provides a description of the empirical analysis of the available SOI data. In addition, the description includes the assumptions obtained from recent surveys applied to the data.

The SOI data provides the fair market value of IRA balances by income class. The following table provides the distribution of these accounts.

Size of Adjusted Gross Income	Traditional IRAs		Roth IRAs	
	Number of Taxpayers	End of Year Fair Market Value	Number of Taxpayers	End of Year Fair Market Value
Under \$25,000	6,709,243	424,653,213	1,951,582	35,153,939
\$25,000 under \$50,000	7,093,809	517,785,304	2,516,255	41,729,777
\$50,000 under \$75,000	6,875,405	616,586,595	2,686,643	55,067,659
\$75,000 under \$100,000	5,907,588	631,153,703	2,637,792	55,844,369
\$100,000 under \$200,000	10,298,361	1,408,859,786	5,000,138	125,171,614
\$200,000 or more	4,669,496	1,019,501,810	1,650,075	90,033,167
Total	41,553,902	\$4,618,540,411	16,442,485	\$403,000,525

The SOI provides additional information for IRAs, including average fair market value of IRAs by type of account and adjusted gross income. This provides a basis for excluding certain taxpayers, by income class. To estimate account balances, the analysis assumes a normal distribution of average account balances within each income class (Table 3 provides an abbreviated distribution; however for purposes of this analysis, the detailed income distribution utilizes 15 separate income classes). This assumption provides a basis for excluding taxpayers that may have higher account balances (attributable to rollover activity or a long contribution history), but are at lower income levels.¹⁰⁵

Under the re-proposed regulation, many smaller account IRA investors could lose access to an investment professional through a brokerage relationship. The analysis estimates that the number of taxpayers within each income class with average account balances that would lose

¹⁰⁵ In addition, this analysis relied on additional tabulations using the Quantria Strategies individual income tax model to supplement and support the information provided by the SOI tables.

access to brokerage accounts is approximately 8.5 million taxpayers.¹⁰⁶ The analysis excludes nearly all taxpayers with adjusted gross incomes in excess of \$100,000, because these taxpayers are likely to have adequate financial resources to hire professional investment advisers (if they are not doing so already).

Similar to the Oliver Wyman and EBRI estimates, this estimate used conservative assumptions of existing IRAs, assuming that 60 percent of the 8.5 million accounts that would be below minimum account levels for any advisory account would migrate to a “low support” brokerage account.¹⁰⁷ This lower level of support will result in lower intensity of financial advice, which is likely to result in reduced returns for these accounts. The estimated reduction is assumed to be 100 basis points applied to the projected fair market value for 2014.

In addition, the analysis considers the effects of the re-proposed regulations on the incentives to open IRAs. It is likely that the re-proposed regulations might discourage IRA creation.¹⁰⁸ Under the re-proposed regulation, these new IRA investors would not have access to an investment professional and are likely to face diminished returns of approximately 200 basis points.

2. Qualified Plans

a. Reduced Contributions and Reduced Access to Investment Advice – We first estimate pension participation contributions by income class. The SOI data provide the starting point for this step. The SOI presents tabular data based on information collected from matched samples of Form 1040, U.S. Individual Income Tax Return; and Form W-2, Wage and Tax Statement, for Tax Years.

Data from individual income tax returns rely on a stratified probability sample.¹⁰⁹ Information on wages and retirement contributions rely on Forms W-2 matched to the sampled individual income tax return. The individual income tax return provides information on the gender and age of a taxpayer (obtained by matching the primary and secondary Social Security numbers on the individual income tax return to information from the Social Security Administration). Form W-2, box 12 provides detail on the type of retirement plan. The SOI collects this information on an individual taxpayer basis. These estimates retain information on age, gender, filing status, and wage and salary income levels to reflect certain characteristics that are likely to affect account balances.

We impute aggregate balances for the distribution of taxpayers reporting retirement contributions on Form W-2 relying on data from two surveys, which provides an opportunity to verify and corroborate the assumptions applied to the taxpayer characteristics. The first survey is the Survey of Consumer Finances (SCF), a survey of U.S. households sponsored by the Board of

¹⁰⁶ Oliver Wyman estimated that, based on account minimums for advisory accounts and IRA data available in 2011, 7.2 million IRAs from the survey data would not qualify for financial assistance through an advisory account. The survey data represented 40 percent of the IRA market.

¹⁰⁷ The EBRI IRA data base indicates that the median IRA account balance is under \$25,000.

¹⁰⁸ This portion of the analysis excludes new IRAs that would have been created with rollover contributions as these are accounted for in our calculations relating to retirement plan participants.

¹⁰⁹ Refer to Statistics of Income—2010, Individual Income Tax Returns documentation for the description of the sampling procedures and data limitations of Statistics of Income tabulations.

Governors of the Federal Reserve System with the cooperation of the U.S. Department of the Treasury every three years. The second survey is the Employee Benefits Research Institute and the Investment Company Institute (EBRI/ICI) survey of retirement plans. The EBRI/ICI survey collects information about individual 401(k) plan participant accounts. As of December 2010, the database included information about 23.4 million 401(k) plan participants in 64,455 employer-sponsored 401(k) plans, representing \$1.414 trillion in assets. In addition, the EBRI/ICI survey collects data from plan record keepers and, therefore, is able to capture the characteristics of the plan activity. The survey retains information on demographic, contribution, asset allocation, and loan and withdrawal activity information for millions of participants, which enables estimates of the cumulative changes in account balances. Together, these surveys provide qualitative information that allows imputation of account balances.

i. Loss of Advice that Contributes to Increased Retirement Savings – In addition to the account balance assumptions calculated from SOI and survey data, the analysis calculates the estimated deferral rates for these retirement accounts.¹¹⁰ The estimate assumes that the differences in deferral rates are consistent with data in the Financial Engines/AON Hewitt report that shows people using advice services have higher average contribution levels than other participants.¹¹¹ The reduced deferral rates were applied to average income of a subset of retirement plan participants. The subset of participants reflects the SOI tabulation data, adjusted for the estimated participants who seek advice. These assumptions capture individuals who would have saved for retirement with a financial adviser, who will no longer save, and individuals who would have saved more for retirement with a financial adviser, who will reduce their retirement savings amounts when they lose access to a financial adviser.

ii. Reduced Access to Financial Advice – DOL previously estimated that retirement plan participants made investment mistakes of approximately \$114 billion in 2010 due in large part to the lack of financial advice. This analysis applies the same methodology as described in the 2011 regulations.¹¹² As mentioned above, these estimates include only those plan participants who are likely to seek advice. The reduction in advisory services is likely to reduce performance for these participants by approximately 25 to 75 basis points.

b. Account Balance Leakage – The estimates of increased cash-outs from qualified retirement savings rely on a number of data sources as well as our estimates of the effects of reducing employee access to assistance through call centers and broker-dealers. The estimates attempt to characterize and quantify the potential asset erosion from retirement savings when participants are unable to obtain assistance at job change, when they must make decisions regarding their retirement plan assets. We first estimate pension participation and IRA contributions by income class. Because cashouts of retirement savings at job change tend to

¹¹⁰ As the previous discussion indicates, there is likely to be positive effect associated investment diversity and seeking employer matching amounts. However, this estimate focuses conservatively on deferral rates, as information supporting the other positive effects is limited.

¹¹¹ Refer to Aon Hewitt, *Help in Defined Contribution Plans, 2006 through 2012, 2013*.

¹¹² U.S. Department of Labor, Employee Benefits Security Administration, 29 CFR Part 2550, Investment Advice – Participants and Beneficiaries, D. Regulatory Impact Analysis, Federal Register, Vol. 76 No. 206, Tuesday, October 25, 2011.

correlate negatively with income (i.e., individuals with higher income are less likely to cash out their retirement savings at job change), we can use the income distribution of pension and IRA participation to help us capture these effects.

As described above, we impute aggregate balances for the distribution of taxpayers reporting retirement contributions on Form W-2 relying on data from the SCF and EBRI/ICI surveys, which provides an opportunity to verify and corroborate the assumptions applied to the taxpayer characteristics. Based on the survey information, we rely on information on demographic, contribution, asset allocation, and loan and withdrawal activity information for millions of participants, which enables estimates of the cumulative changes in account balances. Together, these surveys provide qualitative information that allows imputation of account balances.

From this base, we estimate those qualified plan participants who experience a break in service (through job termination) and face a decision regarding plan assets held with their previous employer. The Job Opening and Labor Turnover Survey (JOLTS) from the Bureau of Labor Statistics provides current statistics on labor turnover by selected worker characteristics. The JOLTS measures hires and separations on a monthly basis. Historical estimates that correspond with the reference year data (2010) support these estimates.

Finally, we investigate the role of financial planners and brokers in helping workers save for retirement. Our research (described in detail below) relies on a DOL-sponsored pilot survey conducted through the Rand American Life Panel that looks at how current enrollees in employer-sponsored defined contribution (DC) plans make retirement decisions.

Rand American Life Panel (ALP) – Since 2006, the Rand Corporation has fielded a survey of approximately 6,000 individuals who have agreed to participate in occasional, on-line surveys on topics of interest to policymakers. Approximately 350 surveys have been conducted to date on topics as diverse as financial decision-making, financial literacy, self-reported health and well-being and Social Security knowledge. Participants in the ALP are selected from several other, on-going surveys in the United States including the University of Michigan Monthly Survey, the National Survey Project cohort and active recruitment based on the nature of the survey.

For the purposes of this research, we focus primarily on the demographic characteristics of workers enrolled in employer-sponsored DC plans, plan balances, the investment decisions of the plan participants, indicators of financial literacy, and the decision to rely on a financial planner or broker to assist in retirement decisions.

The Model – For this research, we constructed an econometric model of plan balances for workers in the Well Being 189 Survey who indicated they were enrolled in a company-sponsored DC plan.¹¹³ We investigate how access to a financial planner might affect retirement savings outcomes. For this purpose, we define plan balances as the sum of (1) current plan balances; (2) balances in plans from prior employers; and (3) any IRA or Keogh plan balances that the respondent may have. Of the 3,061 survey respondents, 837 met our criteria.

¹¹³ We note that DOL criticized the use of their own survey, but provided no detailed reasons why the results, which are consistent with other data on the benefits of access to financial advice, should be rejected. Therefore, we believe this survey provides relevant support for this analysis.

We also construct several variables from the Survey that we believe should be strong predictors of retirement savings:

AGE:	The age of the respondent.
AGESQR:	The age of the respondent squared (to capture life-cycle effects).
INCOME:	Total income of the respondent.
CHRONIC:	An indicator if the respondent reported suffering from a chronic disease such as cancer, diabetes or stroke.
TENURE:	An indicator if the respondent owned a home.
FRACTION_STOCK:	The fraction of current plan balance that is invested in stocks.
LITERACY:	An index of financial literacy.
PLANNER:	An indicator if the respondent said he/she relied on a financial planner or broker for assistance.

We expect total plan balances to be positively related to income, which captures the fact that a higher income should result in more resources devoted to retirement savings. In contrast, we expect retirement savings to be negatively related to health status (as captured in the CHRONIC variable) as this could mean time spent out of the labor force, reduced hours of work, or other impediments to lifetime earnings. Similarly, we expect retirement savings to be positively related to owning a home (TENURE), suggesting that homeowners may have more resources that can be devoted to saving for retirement.

We have no a priori expectation about how the fraction of stock in one's portfolio might affect plan balances. Because stocks generally have higher long-term growth than bonds, we would expect this variable to be positively related to plan balances. On the other hand, because the survey was conducted in mid-2011, those plans with a large stock component could have suffered from the recent financial crisis. We expect financial literacy to be positively correlated with plan balances to the extent enrollees make better financial decisions relating to their retirement savings. Finally, we expect that plan balances should be positively related to seeking planning advice from a professional advisor.

In order to control for the wide variation and degree of skew in plan balances, we use the natural logarithm of total plan balances as our dependent variable. We also use the natural logarithm of total income as a predictor variable. Refer to the original Quantria Strategies research, *Access to Call Centers and Broker Dealers and Their Effects on Retirement Savings*, Appendix Table 1 and Appendix Table 2. These tables show that, of our sample of 837 enrolled workers, the average age is 47 years, approximately 32 percent have experienced some type of chronic health problem, 78 percent are homeowners, about 74 percent of current plan balances are in stocks, and slightly more than half consulted with a financial planner.

Results – The estimated coefficients conform to our expectations about how certain variables relate to plan balances. The positive coefficient on AGE shows that, at least for our sample, plan balances at first rise with age, as one would expect. In contrast, the negative coefficient on AGESQR indicates that balances begin to increase at a slower rate at some point in the life-cycle, perhaps due to withdrawals or a movement towards safer, fixed-income investments as one gets older.

Plan balances correlate positively with income and homeownership as indicated by the positive coefficients on these two variables and correlate negatively with health status. Both these results are expected. The fraction of plan balances held in stocks (FRACTION_STOCKS) suggests a strong, positive effect on plan balances. As expected, larger plan balances are positively related to financial literacy and the use of a financial planner. Because of the log specification of our model for plan balances, we can interpret the coefficient on PLANNER as indicating that plan balances are about 33 percent higher if an individual consulted a financial planner or broker for financial advice. All the coefficients in our model, except CHRONIC, are statistically significant at 95 percent confidence intervals. The adjusted R-square of 0.28 is reasonably high for cross section data.

3. Small Business Plans

Analysis of the potential cost of the re-proposed regulations on small business retirement plans (including IRAs) relies on data from the Internal Revenue Service Statistics of Income (SOI). The following provides a description of the empirical analysis of the available SOI data. In addition, the description includes the assumptions obtained from recent surveys applied to the data.

The SOI data provides the fair market value of SEP and SIMPLE IRA balances by income class. The following table provides the distribution of these accounts. This analysis follows closely the analysis of IRAs described above.

To estimate account balances, the analysis assumes a normal distribution of average account balances within each income class (Table 4 provides an abbreviated distribution, however for purposes of this analysis, the analysis utilizes detailed income distribution across 15 separate income classes). This assumption provides a basis for excluding taxpayers that may have higher account balances (attributable to a long contribution history or higher contribution amounts), but are at lower income levels.¹¹⁴

¹¹⁴ In addition, this analysis relied on additional tabulations using the Quantria Strategies individual income tax model to supplement and support the information provided by the SOI tables.

Table 4.—Fair Market Value of SEP and SIMPLE IRAs, 2012
Source: IRS, SOI, Table 3. Taxpayers with IRA Plans, by Type of Plan and by
Size of Adjusted Gross Income, Tax Year 2012
(thousands of dollars)

Size of Adjusted Gross Income	SEP IRAs		SIMPLE IRAs	
	Number of Taxpayers	End of Year Fair Market Value	Number of Taxpayers	End of Year Fair Market Value
Under \$25,000	328,985	16,378,382	271,075	3,307,618
\$25,000 under \$50,000	387,097	15,506,108	564,237	6,823,720
\$50,000 under \$75,000	393,333	23,085,005	452,086	8,875,497
\$75,000 under \$100,000	379,094	26,746,313	392,072	8,796,495
\$100,000 under \$200,000	887,567	82,040,689	551,285	23,040,813
\$200,000 or more	647,032	108,163,780	268,988	21,020,046
Total	3,023,108	\$271,920,277	2,499,743	\$71,864,189

Based on SOI data, approximately an additional 570,000 SEP and SIMPLE accounts would be below minimum account levels for an advisory account and would migrate to a “low support” brokerage account. This lower level of support is likely to result in reduced returns for these accounts. The estimated reduction is assumed to be 100 basis points applied to the projected fair market value for 2014.

While existing plans may face a reduced level of investment advisory services, this effect is not included in this estimate as over time, the account balances may be large enough to warrant a higher level of services. However, the re-proposed regulations may reduce availability of financial advisers for small businesses with respect to retirement savings plans and a reduction in both the number of small businesses offering retirement plans to their employees and a reduction in total retirement savings could be expected.¹¹⁵

A recent survey found that a substantial percent (67 percent) of small businesses that do have retirement plans rely on a financial adviser or record-keeper to assist in investment selection and monitoring (Greenwald & Associates survey).¹¹⁶ Especially in the case of smaller companies (10-49 employees), a financial adviser plays an important role in assisting with the retirement plan. Contrast this with the fact that a relatively small percentage of small business owners (less than one-third) have worked with an adviser on a business plan, suggesting that financial advisers play key roles in the establishment of retirement savings plans by small businesses.¹¹⁷

¹¹⁵ This number is likely to be small relative to the difference in investment performance associated with existing accounts. However, over time, it is something that would have far reaching impacts.

¹¹⁶ *The Impact of the Upcoming Re-Proposed Department of Labor Fiduciary Regulation on Small Business Retirement Plan Coverage and Benefits*, Greenwald & Associates, May 14, 2014.

¹¹⁷ CNBC/FPA survey, *supra*.

Therefore the analysis includes estimates of the likely number of small business pension plans that would not be established, based on data from the EBRI analysis of employment-based retirement plans.¹¹⁸

4. Interaction Effects

As mentioned previously, there are a number of interactions between account holders of employer-sponsored retirement plans, IRA holders, and small business accounts. IRAs may be held by individuals who currently participate in an employer plan. Small business plans may be an IRA or another qualified retirement plan (e.g. 401(k) plan). In addition, participants in qualified plans may rollover balances from the employer plan to an IRA. Therefore, to address the potential for double counting, the analysis adjusts each estimate for the relative degree of overlap, based on available information, which reduces the overall effect of any individual component.

¹¹⁸ Refer to Copeland, Craig, *Employment-based Retirement Plan Participation: Geographic Differences and Trends, 2013*, Employee Benefits Research Institute, No. 405, October 2014.

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***Response to Advanced Analytical Review of Quantria Strategies, LLC Study on
Access to Call Centers and Broker Dealers***

The Department of Labor commissioned a private firm, Advanced Analytical, to critique the April 2014 Quantria Strategies, LLC study titled “*Access to Call Centers and Brokers Dealers and Their Effects on Retirement Savings.*” Because the Advanced Analytical report misrepresents the Quantria study with respect to certain key points, the analysis below addresses these inaccuracies.¹

Importantly, Advanced Analytical notes in its conclusion “the basic idea behind the study – that expanded fiduciary responsibilities may reduce financial advice and increase cash outs – is possible...depending upon the content of the regulation, ***there may be a modest increase in cash-outs*** (emphasis added).”

Given the magnitude of rollovers from qualified plans to individual retirement arrangements (IRAs), even a modest increase in cash-outs would have an immense economic impact. The Internal Revenue Service data indicated that IRAs received rollovers totaling ***\$309.5 billion*** in 2012.² Thus, while Quantria’s estimated \$20 – 32 billion increase in cash outs may be characterized as “modest” relative to total rollovers, it reflects a significant change in retirement savings that warrants careful consideration by the Department.

Advanced Analytical statement – “Quantria Assumed that Re-Proposed Regulations Will Eradicate All Forms of Financial Advice on What to Do with Plan Balances on Job Separation”

Nowhere in the Quantria study is there a statement that the re-proposed regulations would “***eradicate all forms***” (emphasis added) of financial advice on job separation. Rather, the Quantria study states that the regulations are “generally expected to create fiduciary responsibility for financial service providers that ‘***will limit***’ (emphasis added) the access to assistance provided by call centers and broker dealers when terminating employees face plan distribution decisions.”

Limiting access to assistance will have serious adverse effects, but it does not reflect an assumption that the proposal would “eradicate all” access to assistance.³ The point of the Quantria Strategies analysis was that adopting regulations without adequate accommodation for certain common forms of assistance currently provided to employees, such as the availability of a call-in center to help terminating employees make decisions about what to do with their account balances, could result in the elimination of these forms of assistance. The Quantria

¹ It should be noted that Advanced Analytical did not contact Quantria to confirm any of their assumptions made about the Quantria report.

² Refer to the Internal Revenue Service, Statistics of Income, Matched file of Forms 1040, 1099-R, and 5498 for Tax Year 2012, *Table 1. Taxpayers with Individual Retirement Arrangement (IRA) Plans, by Type of Plan, Tax Year 2012.*

³ When the Quantria study was prepared, no information existed on the scope of the re-proposed regulations.

study did not assume and, in no way implied, that the regulations would eliminate all forms of financial advice.

Advanced Analytical statement – “Quantria Interpreted a Correlation as a Causal Effect.”

Quantria explained explicitly in a meeting with the Office of Management and Budget that the econometric model used in the Quantria report was not a structural model that could be used to show a causal effect. However, Quantria’s regression analysis suggests there is a relationship between cash outs and access to financial advice, even accounting for other characteristics, including wealth, income, and financial literacy. All of these characteristics are captured in the Quantria model. We also note that the Department of Labor inferred a strong relationship between access to financial advice and retirement savings behavior based on comparable data in the 2011 analysis of the effect of regulations relating to prohibited transaction exemptions.⁴

Other studies have also found a link between access to financial advice and retirement savings outcomes. Despite this, the data cited to support the proposed regulation primarily look at rates of return in the commercial market, rather than rates of returns for qualified retirement plans and do not consider any other potential effects of financial advice on qualified retirement savings, including increased participation rates, increased savings rates, and reduced cash-out rates.

Advanced Analytical statement – “Quantria Misrepresented Lump Sum Distributions as Cash Outs.”

Advanced Analytical focused on a single number that was not a relevant source of Quantria’s calculations. While it is true that the number cited represented average lump-sum distributions over a period of time, this number was not used as the basis for Quantria’s estimates.

Advanced Analytical is correct that lump-sum distributions can be distinguished from cash outs. Cash outs represent “leakage” of retirement savings; in other words, cash outs represent distributions that result in pure losses of qualified retirement savings.⁵ Quantria relied on a number of different data sources to arrive at the assumptions used to quantify the size of cash outs. For example, Argento et al. 2013 found that, in 2010, total distributions from retirement savings plans for taxpayers under age 55 totaled \$241 billion and for taxpayers age 55 or older totaled \$1,040.2 billion. Table 1 shows the portion of these total distributions that were taxable distributions.

⁴ Federal Register, Volume 76, No. 206, Rules and Regulations, Tuesday, October 25, 2011.

⁵ For this purpose, pure losses of retirement savings mean withdrawals from qualified retirement savings that are used for nonretirement purposes by taxpayers who have not yet retired from work. Advanced Analytical noted that cash out balances could be used for other purposes, such as investing in a home or business; while this is true, these amounts do not represent qualified retirement savings, which was the focus of the Quantria analysis.

Table 1. Taxable Retirement Account Distributions, 2010			
<i>[Billions of dollars]</i>			
Type of Distribution	All Returns	Age < 55	Age 55+
Taxable, non-penalized	746.7	57.1	689.6
Taxable, penalized	57.8	47.3	10.5
Total, taxable distributions	804.5	104.4	700.1
Source: Argento, Robert, Victoria L. Bryant, and John Sabelhaus. <i>Early Withdrawals from Retirement Accounts During the Great Recession</i> . Federal Reserve Board, Washington, DC, Divisions of Research & Statistics and Monetary Affairs, Finance and Economics Discussion Series, 2013-22, March 2013.			

Distributions that are both taxed and penalized (\$57.8 billion in Table 1) represent pure losses of qualified retirement savings. In addition, some portion of the \$700.1 billion of taxable non-penalized distributions also represent pure losses of qualified retirement savings; for those age 65 and over, most taxable, non-penalized distributions likely represent the use of qualified retirement savings as retirement income.

For some taxpayers (particularly those under age 55 and those in the age 55-65 category), a significant portion of the taxable, non-penalized distributions will also represent pure losses of qualified retirement savings. As a result, in 2010, cash outs of retirement savings totaled somewhere between \$57.8 billion and \$804.5 billion.⁶ Assuming that no more than 10 percent of the taxable, non-penalized distributions represent cash outs, the applicable potential range of cash outs for 2010 would be \$57.8 to \$132.5 billion.

Advanced Analytical statement – “There is No Apparent Connection between Quantria’s Calculations of Incremental Cash-Outs and Reduced Lifetime Retirement Savings.”

The relationship between cash outs and reduced lifetime savings is not a new concept. Policymakers focus on the potential of the current system to create incentives for taxpayers to withdraw (through loans, qualified withdrawals for special purposes, and cash outs at various times in the working career (e.g. change of employment)). The concern is that such actions will result in inadequate accumulation of retirement savings.

The economic literature offers a number of examples of research that confirms this finding. Most recently, research by the Center for Retirement Research at Boston College conducted by Munnell and Webb find that aggregate 401(k) and IRA retirement wealth is at least 20 percent lower than it would have been without current leakage.⁷

Other examples include the Government Accountability Office, *401(k) Plans – Policy Changes Could Reduce the Long-Term Effects of Leakage on Worker’s Retirement Savings*; Congressional Research Service, *Pension Issues: Lump-Sum Distributions and Retirement Security*; and earlier

⁶ Refer to Argento, Robert, Victoria L. Bryant, and John Sabelhaus. *Early Withdrawals from Retirement Accounts During the Great Recession*. Federal Reserve Board, Washington, DC, Divisions of Research & Statistics and Monetary Affairs, Finance and Economics Discussion Series, 2013-22, March 2013.

⁷ Refer to Munnell, Alicia H. and Anthony Webb, *The Impact of Leakages from 401(k)s and IRAs*, WP-2015-2, February 2015. The Munnell and Webb results, published after the Quantria results, confirm these findings.

work by Poterba, Venti, and Wise, *Preretirement Cashouts and Foregone Retirement Saving: Implications for 401(k) Asset Accumulation*.⁸

Quantria's examples were not intended to relate directly to the estimates of increased cash outs, but rather were intended (as specifically stated in the report) to show examples of the effects of cash outs on retirement savings balances. The Quantria report states that cash outs could "reduce the ultimate retirement savings of **affected individuals** (emphasis added) by 20 to 40 percent." The report did not state nor imply that total retirement savings would decline by 20 to 40 percent.

⁸ Refer to United States Government Accountability Office. *401(k) Plans. Policy Changes Could Reduce the Long-Term Effects of Leakage on Workers' Retirement Savings*. Report to the Chairman, Special Committee on Aging, U.S. Senate. GAO-09-715, August 2009; Purcell, Patrick. *Pension Issues: Lump-Sum Distributions and Retirement Income Security*. Congressional Research Service, RL30496, January 7, 2009; and Poterba, James M., Steven F. Venti, and David A. Wise. *Pre-Retirement Cashouts and Foregone Retirement Saving: Implications for 401(k) Asset Accumulation*. National Bureau of Economic Research, Working Paper 7314, August 1999.

April 12, 2011

Oliver Wyman report: Assessment of the impact of the Department of Labor's proposed "fiduciary" definition rule on IRA consumers

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About this study

On behalf of a group of 12 financial services firms that offer services to retail investors, Davis and Harman LLP engaged Oliver Wyman to analyze the impact on Individual Retirement Account (IRA) investors of the Department of Labor's proposed change to the rule defining a "fiduciary" for purposes of the Employee Retirement Income Security Act of 1974 ("ERISA") and section 4975 of the Internal Revenue Code of 1986, as amended (the "Code").

The firms participating in this study collectively represent over 19 million IRA holders who hold \$1.79 trillion in assets through 25.3 million IRA accounts. This constitutes approximately 40% of IRAs in the United States and 40% of IRA assets. Due to the highly sensitive nature of firm-specific information, all data is presented in aggregated form in this report.

In particular, Oliver Wyman was asked to evaluate the potential impact, if enacted, of the proposed rule change on smaller retail IRA investors with respect to:

1. access to investment help and services from a licensed investment professional,
2. choice of investment professional, relationship model in terms of commission-based brokerage versus single fee, "wrap" investment advisory accounts, as well as breadth of product choice, and
3. cost impact to IRA holders.

Summary of key findings

IRAs are the fastest growing accounts holding retirement savings.

IRAs are widely held by small investors.

- Nearly 40% of IRAs in the study sample had less than \$10,000.

Small investors overwhelmingly favor brokerage relationships over advisory relationships.

- 98% of investor accounts with less than \$25,000 were in brokerage relationships.

The proposed rule could eliminate access to meaningful investment services for over 7 million IRAs.

- IRA investors would no longer be able to receive investment services and help from an investment professional as part of a brokerage relationship.
- Because of account minimums, 7.2 million current IRAs would not qualify for an advisory account with any firm in the study.

The proposed rule could well result in hundreds of thousands of fewer IRAs opened per year.

- In 2010, firms in the study sample opened approximately 890,000 brokerage IRA accounts with assets of less than \$10,000.
- Under the proposed rule, small investors interested in opening an IRA would have less access to investment professionals for guidance and support, making it less likely that they would open an IRA.

Many IRA holders would have reduced choice of investment professional, as over one-third of client-facing financial professionals in the industry would not be licensed to help retail investors with their IRA account needs under the proposed rule.

The brokerage IRA investors who could be served in an advisory model would likely face increased costs as a result of the rule-driven change.

- In the study sample, estimated direct costs would increase by approximately 75% to 195% for these investors.

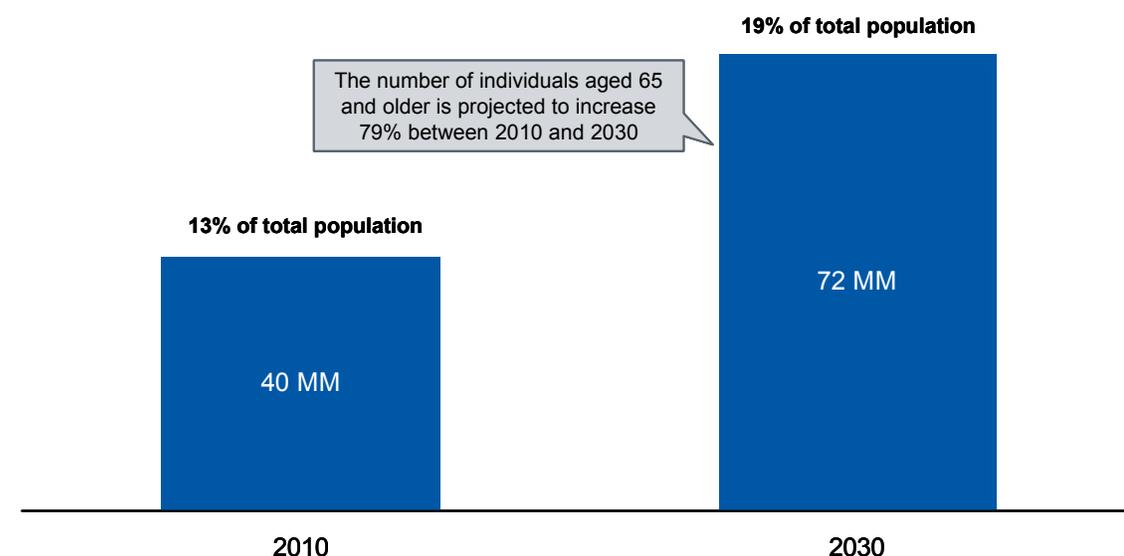
1. The outlook for U.S. retirement savings and the role of the IRA

Personal retirement savings are an essential part of funding the future retired population

As is well documented in numerous studies, the U.S. population is aging. The number of retired Americans aged 65 or over is projected to swell nearly 80% to 72 million by 2030 compared to 40 million today.

Figure 1: The U.S. population is aging

Increase in the 65 and over population, 2010 – 2030



Source: US Census Bureau 2008 release
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At the same time, Americans increasingly need to take on far more proactive personal planning for their own retirement income. Former support mechanisms such as employer-sponsored defined benefit pension plans are disappearing (over 65% of individuals with an employer-sponsored retirement plan were in a defined benefit pension plan at the end of the 1980s, compared with only 36% of individuals by the mid 2000s¹). Furthermore, the Social Security system is coming under increasing stress amid U.S. funding and budgetary issues as the population skews towards older individuals in the savings decumulation period of their lives.

We estimate total personal financial assets in the U.S. today amount to \$53 trillion, of which \$40 trillion can be considered investable.² As Figure 2 shows, the growth outlook for many of the major asset classes is challenged, which we expect will increase the

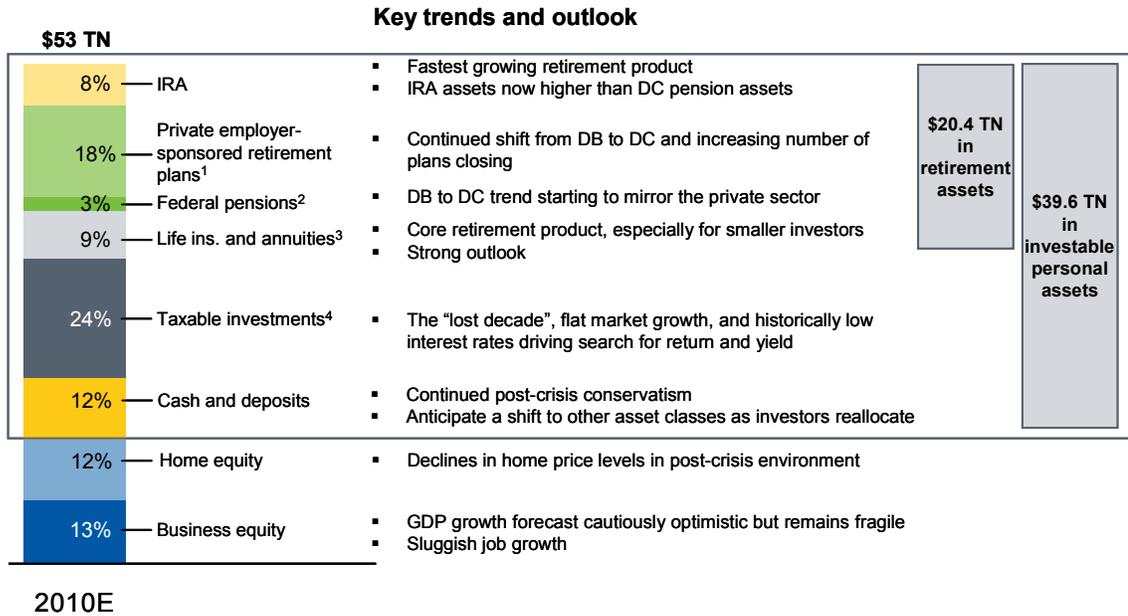
¹ ICI, 2009, EBRI Databook

² Oliver Wyman analysis, Federal Flow of Funds, Cerulli, American Council of Life Insurers

importance of personal retirement savings. Of the total, approximately \$20.4 trillion constitute specific retirement assets in the form of IRAs, pensions, life insurance and annuities.

Figure 2: Retirement assets constitute ~\$20 TN of the total \$40 TN of investable personal financial assets in the U.S.

U.S. personal retirement assets, year-end 2010



Source: Oliver Wyman analysis, Federal Flow of Funds, Cerulli, American Council of Life Insurers

1. Includes public sector DB plans and DC plans (Taft-Hartley, 403(b), 457), and private sector DB and DC plans (401(k), money purchase plans, profit sharing plans, Keoghs); category excludes those assets invested in annuities to avoid double-count

2. Includes Federal DB plans (Civil Service Retirement Systems, FERES, Military Retirement Fund, National Railroad Retirement Trust, Railroad Retirement Board) and DC plans (Federal Thrift Savings Plan); excludes Social Security

3. Includes general and segregated funds held on behalf of US policyholders and annuitants; excludes life insurance reserves

4. Includes Corporate equities, Mutual Fund Shares, Money Market Fund Shares, Credit market instruments less IRAs

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IRAs are a critical and rapidly growing part of U.S. retirement savings

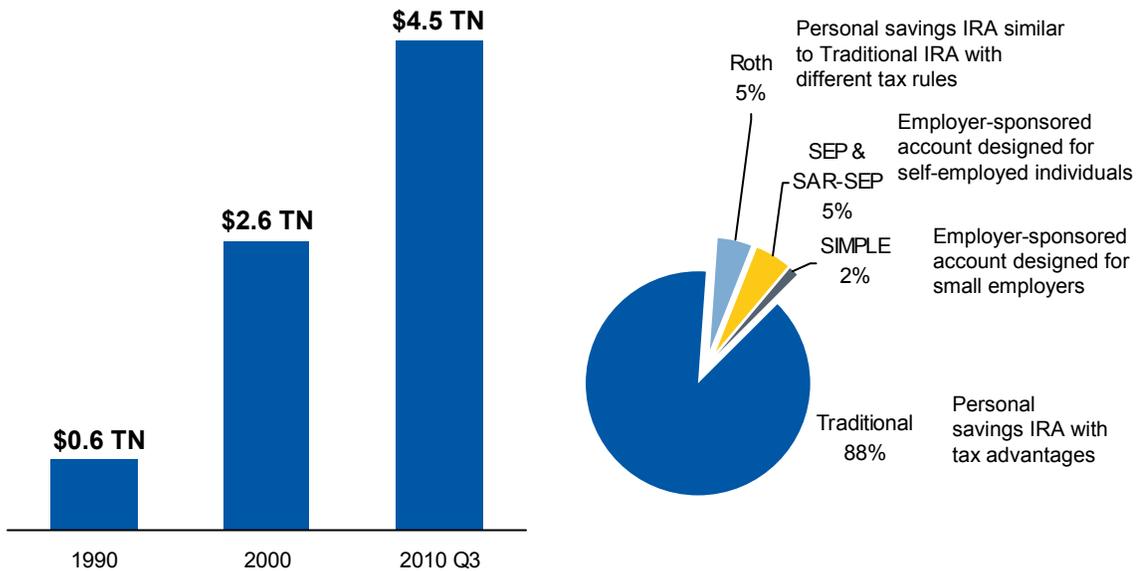
Since their introduction in 1974, IRAs have grown to represent around 8% of total personal financial assets in the U.S. today³, representing \$4.5 trillion. 49 million U.S. households hold an IRA and for 8% of households IRAs represent the only form of retirement savings.⁴ IRAs are the fastest growing investment accounts holding retirement savings and have become an ever more important part of U.S. households' future funding, increasing from 16% of retirement market assets to 27% in the 20 years from 1990 to 2010.⁵

³ Federal Flow of Funds, Cerulli, American Council of Life Insurers, Oliver Wyman Analysis

⁴ ICI, Research Fundamentals, 2010

⁵ ICI, The U.S. Retirement Market for Q3 2010, released 2011

Figure 3: IRAs are growing rapidly with traditional IRAs continuing to dominate⁶
 IRA growth and distribution by type, 1990 – 2010



Source: ICI Q3 2010, Cerulli 2009 Retirement Markets, Oliver Wyman estimates

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As a tax-advantaged savings vehicle, IRAs play a critical role in private savings. Subject to certain conditions, IRAs enable investors to retire with more wealth than if they had invested through a taxable account. Similarly, IRAs help eliminate distortions in asset allocation and investment risk by allowing investors to defer taxes on investment income, thereby leveling the field between capital gains-oriented equities and income-generating investments such as bonds and dividend-paying stocks. Finally, IRAs and other tax-deferred products enable investors to make optimal portfolio rebalancing decisions independent of tax considerations.

The retail financial services industry currently offers a range of relationship models in response to the diversity of investor needs

With investment savings, like many things, the most difficult step is often the first one, and many retail investors seek support from a financial advisor and/or brokerage firm serving as an IRA custodian to help them through the technical, and largely tax-driven requirements of setting up and funding an IRA through cash contributions or rolling money over from an existing qualified retirement plan. Opening a retirement account is

⁶ Source: ICI Q3 2010, Cerulli 2009 Retirement Markets, Oliver Wyman estimates

just the beginning, however. It takes personal discipline to remain on track, and investors need to continue to make regular contributions to their account over a long time period in order to benefit from compounded growth of their investment savings.

Investors seek a wide range of assistance – from more basic tax information and asset allocation modeling to sophisticated, investment-specific guidance from investment professionals. Two primary IRA business models have evolved to serve all investor types. These two primary channels through which individuals access IRA savings accounts are summarized in Figure 4 and described in further detail below.

Figure 4: There are two main IRA business models today

Key attributes of IRA business models

Key Attributes	Advisory	Brokerage	
		Full service	Discount
Investment services needs	<ul style="list-style-type: none"> ▪ Broad financial planning and investment advice 	<ul style="list-style-type: none"> ▪ Product-specific investment information, access to principally-traded products and range of third party and proprietary products 	<ul style="list-style-type: none"> ▪ Product-specific investment information, access to principally-traded products and range of third party and proprietary products
Level of service	<ul style="list-style-type: none"> ▪ Personalized access to an investment professional ▪ Highest ongoing advice and account surveillance 	<ul style="list-style-type: none"> ▪ Personalized access to an investment professional ▪ Information to help investors set up an IRA account and select suitable investments 	<ul style="list-style-type: none"> ▪ Often offer access to an investment professional through a branch or call center ▪ Online investment information, research, tools and calculators to help investors set up an IRA account and select suitable investments
Cost	<ul style="list-style-type: none"> ▪ Tends to be highest cost 	<ul style="list-style-type: none"> ▪ Balanced cost, with costs based on level of trading activity 	<ul style="list-style-type: none"> ▪ Lowest cost, depending on trading activity

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Advisory IRAs offer ongoing advice that may include investment-specific advice, portfolio monitoring, and account surveillance to determine both product-level investment suitability and account make-up. Advisory IRAs involve a relationship with a Registered Investment Adviser (RIA) or dual-registered broker-dealer/RIA. Fees on such IRA accounts are virtually always structured as a “wrap” fee (i.e. an annual client charge of a percentage of account assets).

Brokerage IRAs are offered today in two ways:

- **Full service brokerage** IRAs, in which an investor makes investment decisions, and has regular access to a registered broker representative, plus a range of investment solutions. This typically involves non-continuous, point-in-time help and investment services. In this approach, the brokerage firms are compensated through transaction-specific direct commissions, annual account fees, and various “indirect” sources of compensation (such as marketing and distribution fees paid by mutual funds).
- **Discount brokerage** IRAs, in which an investor makes investment decisions with more limited personal contact (which may occur at a branch or call center), and which often have a full suite of tools to help investors evaluate investment products and transact online. Discount brokerage relationships often have reduced transaction-specific direct commissions, account fees, and indirect compensation.

These two IRA channels have different service models, with different underlying cost structures. Fee-based advisory IRAs involve a number of services that are not present in either of the brokerage channels, such as:

- Ongoing fund and manager research
- Ongoing account surveillance
- Detailed investment performance modeling
- Formalized asset allocation modeling
- Ability for the financial advisor or the firm to utilize discretion with respect to the accounts (a feature in most advisory programs)

Offering these services to advisory investors involves higher costs to the provider, reflecting the required technology investment and compensation for the time financial advisors and support personnel need to spend on each account. In addition, pricing of advisory relationships must reflect the overall liability risk of such relationships. Pricing for the different IRA channels reflects these different underlying cost structures. Accordingly, fee-based advisory IRAs generally represent the highest service level and cost channel for investors.

2. Proposed changes to IRA regulation

In October 2010, the U.S. Department of Labor's Employee Benefits Security Administration announced a proposed rule change to the definition of “fiduciary investment advice” for ERISA-covered qualified retirement plans and IRAs. The proposed change would greatly expand the range of conditions under which an individual who merely provides investment services in a brokerage context would be subject to ERISA fiduciary rules. After receiving a significant amount of public commentary about

the proposed change, the Department of Labor held public hearings on March 1 and 2, 2011, and subsequently opened a 15-day window to receive additional comments.

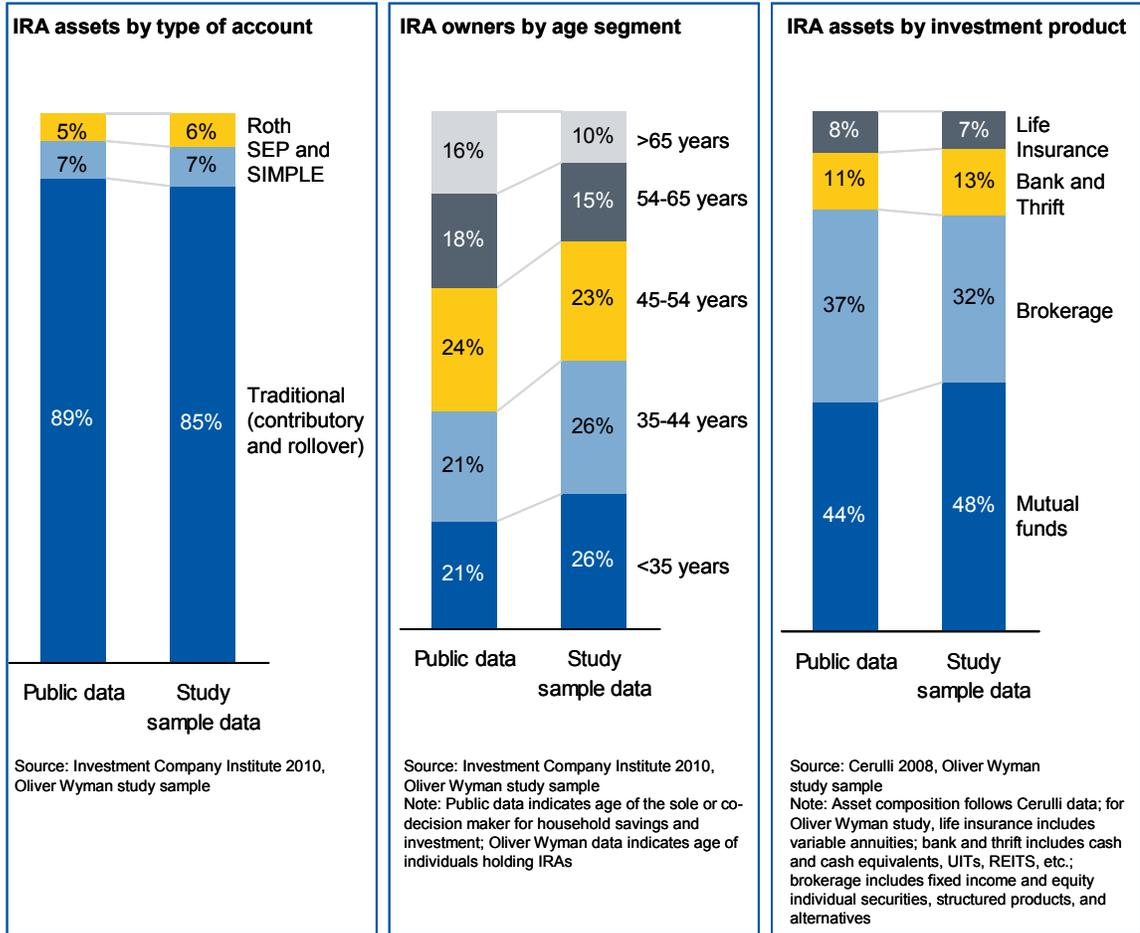
Given the magnitude of potential change for both investors and providers, and a lack of sufficiently granular publicly-available data, Davis and Harman LLP engaged Oliver Wyman on behalf of a group of 12 financial services firms offering retail investment services to analyze the potential impact of the proposed rule on IRA investors. The group of firms participating in this study contributed proprietary firm-level data on their IRAs to create a large sample of IRA market participants. In particular, Oliver Wyman was asked to use the aggregated dataset to analyze the proposed rule with respect to its potential impact on investors' access to investment services and help; investors' choice of relationship model, advisor, and product set; and investors' cost of service.

The study sample in this report provides a unique window onto today's IRA investors, as well as the distribution of key account characteristics such as size and type of account

The aggregate study sample provides an unprecedented view into the range of IRA account characteristics. The participant group in this study represents 40% of both total IRA assets and number of accounts in the U.S. A comparison with publicly available data suggests that the sample broadly mirrors the entire IRA market in type of IRAs held, age of IRA holders, and asset allocation.

Figure 5: The study sample data appears to be highly representative of the total U.S. IRA investor population

Comparison of study sample data to total U.S. IRA population



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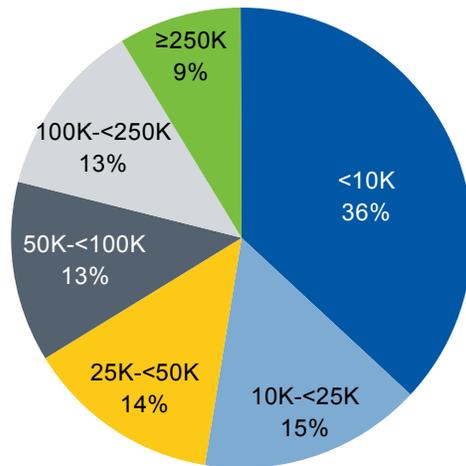
Note that due to limitations in some firms' data, specific analyses may be based on substantial subsets of the entire study sample.

3. IRA investment behavior of smaller investors

As shown in Figure 6, approximately half of IRA investors in the study sample have less than \$25,000 in IRA assets, and over a third have less than \$10,000.

Figure 6: The majority of IRA account holders have lower asset levels

IRA account holders by total IRA asset size segment, year-end 2010

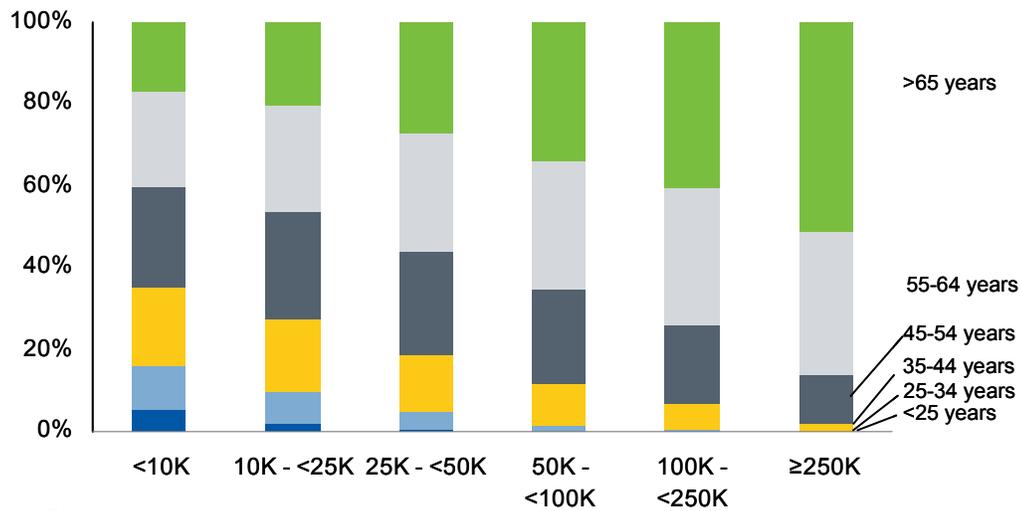


Source: Oliver Wyman study sample

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Although some of these small investors are young and therefore only at the beginning of their savings lifetime, a significant number are also in older age brackets, highlighting the importance of the IRA as a savings vehicle to individuals in their peak savings years.

Figure 7: Very small investors are fairly evenly distributed across age brackets
 IRA investor age distribution by asset size segment



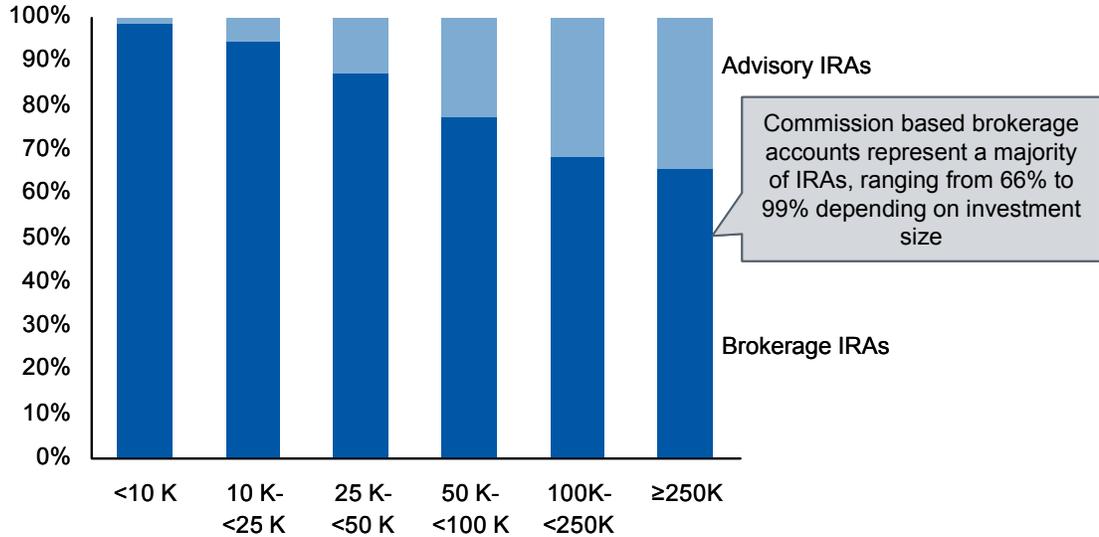
Source: Oliver Wyman study sample

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Investors represented in the study group overwhelmingly use the brokerage relationship model as opposed to a fee-based advisory model, with 22.4 million or 88% holding brokerage IRAs. Brokerage IRAs are more common across all account sizes analyzed, ranging from a high of 99% for accounts with less than \$10,000 to a low of 66% for investors with more than \$250,000 in their IRAs.

Figure 8: Investors prefer transactional, commission-based brokerage accounts over asset-based fee advisory models for IRAs

Proportion of IRAs using each relationship model by asset size segment, year-end 2010



Source: Oliver Wyman study sample
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Of the 2.4 million new IRAs opened with study participants in 2010, nearly 1 million contained assets of less than \$10,000 by year end. Not surprisingly, these accounts also conducted fewer trades on average than larger accounts. Figure 9 shows a summary of IRA holder activity through the study group firms in 2010.

Figure 9: Summary of IRA account holder activity

Year-end 2010

Investor size segment	<\$10K	10K-<25K	25K-<50K	50K-<100K	100K-<250K	≥250K	Total
Number of IRA accounts (MM)	10.1	4.2	3.4	3.0	2.9	1.6	25.3
Number of new IRA accounts opened in 2010 (MM)	0.9	0.3	0.3	0.3	0.3	0.2	2.4
Average number of trades per account	3	5	8	15	25	36	11

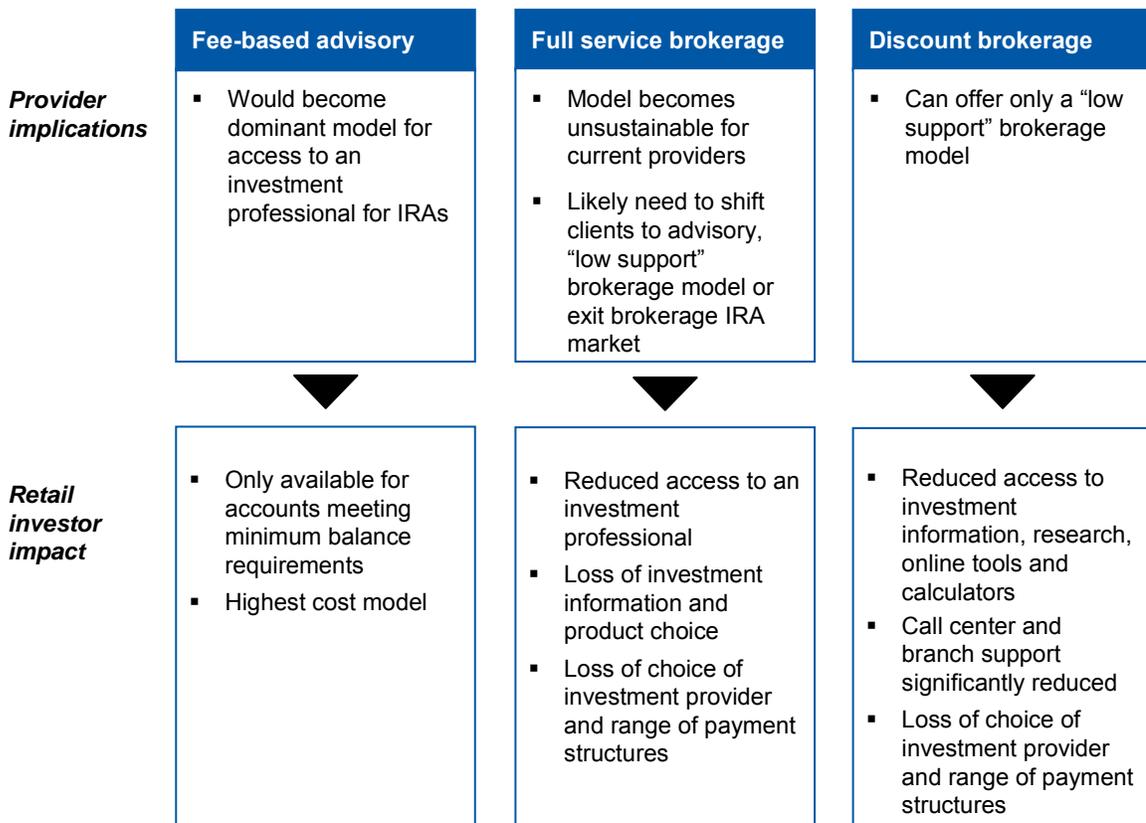
For smaller investors with low trading activity, the brokerage model with predominantly per-transaction charges may be more affordable than the advisory model

Source: Oliver Wyman study sample. Some analyses based on a sub-set of participants, depending on data availability
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4. How the rule change will reshape services for IRA investors

Under the proposed rule, Oliver Wyman expects retail brokerage firms would presume that current brokerage account and service offerings would create a fiduciary duty, and respond by limiting the provision of help and investment services to the fee-based advisory model only

Figure 10: Expected financial industry response and IRA investor impact



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Investors today who have an IRA account through a brokerage relationship receive a range of investment services and help as part of that relationship. However, the proposed rule would appear to make practically every investment-related conversation or interaction with a client subject to fiduciary duty. Interactions that could trigger a broker fiduciary duty to IRA owners under the proposed rule include:

- discussion of investments within an IRA account;

- discussions that clients have with brokers about other, non-retirement account investments if such discussions "may be considered" by the client in an IRA account as well;
- communications regarding firm-wide research on securities;
- valuations of hard-to-value assets;
- IRA "education" (if the Department of Labor does not amend the proposed rule to bring education for IRA owners clearly in scope as non-fiduciary); and
- conversations about rollovers, if the Department of Labor, as discussed in the preamble to the proposed rule, withdraws its prior guidance indicating that such conversations are non-fiduciary.

Because of the broad range of triggering interactions, as a practical matter, firms would need to assume that any IRA investor offered typical brokerage interactions and investment services would be treated as receiving fiduciary services (even if the actions described in the last two bullets do not trigger fiduciary status).⁷ Indeed, if a registered representative is found to be a fiduciary, any transactions performed on behalf of a client could be transformed into prohibited transactions giving rise to severe sanctions (e.g. requirement that transactions be undone) and penalties to the holder. The risk of such sanctions is not one that financial firms will likely bear.

As fiduciaries under the Department of Labor's proposed rule, firms and their associated representatives may not receive different levels of compensation based on the investment choices of retail investors in protected IRA accounts. However, the current brokerage model that has developed to serve IRA accounts is incompatible with this requirement, often involving both direct and indirect fees, such as shareholder servicing fees, sales and distribution fees, revenue-sharing and other fees. These fees frequently vary by product based on factors such as complexity, advisor time requirements (e.g. to explain the risks and benefits and determine client suitability), and services performed such as shareholder servicing. As it stands, the current IRA market has developed around these pricing and risk assumption structures. It would likely be almost impossible to renegotiate myriad contracts with different product manufacturers and create a new level-fee brokerage paradigm just for IRA accounts.

Under the proposed rule, brokerage firms would likely only offer today's level of investment services and guidance to IRA investors through fee-based advisory accounts, which would also include additional services such as ongoing account surveillance required to satisfy a fiduciary duty relationship.

It may be possible for firms to preserve a brokerage IRA option, but this model would likely involve very low support. Such a service model would likely need to involve strict

⁷ The proposed rule would also apply an ERISA fiduciary standard to any entity that is registered as an investment advisor, generally regardless of whether the entity is actually acting in advisory capacity.

limits on baseline services such as offering investment services. Even interactions which are a common part of many discount brokerage relationships today, such as discussions with call center and branch staff, could be curtailed (so as to avoid inadvertently establishing a fiduciary duty).

In addition, some firms without a registered investment advisor may choose to exit the IRA market completely rather than incur the expense involved in setting up an investment advisor and licensing its representatives. (For example, see Figure 13.)

For investors with existing IRA accounts within a brokerage relationship model, we therefore see three potential outcomes:

- 1) Move to an advisory relationship – this will not be feasible for all affected investors, as many may be too small to serve economically as part of an advisory relationship. Indeed smaller IRA holders with low trading activity levels may experience higher fees in this model
- 2) Move to a “low support” brokerage model – this option may not be suitable or even practical for many investors, given the time and expertise needed to understand tax-advantaged investing without outside support, thus significantly impacting current and future IRA holders
- 3) Move existing funds out of the tax-advantaged retirement account market – this could have significant impacts on ultimate savings available to support the retirement of affected investors

Beyond the impact on existing IRA investors, the proposed rule would engender major long-term changes to the ways in which investment services and help could be offered to future investors. Brokerages will no longer have an economic incentive to develop relationships with investors who can only fund a small IRA balance. Instead, firms will look to offer investment services and support only to those whose larger account size can be economically served under the advisory model.

Below, we examine the number of IRA investors in our study sample that could be affected by the changes in service described above.

5. Impact of the proposed rule change on retail investors in the study sample

The proposed rule change would affect the overwhelming majority of investors who rely on brokerage IRA accounts in terms of access, choice, and affordability – this would notably disadvantage small investors

5.1. Reduced access to a licensed professional advisor

In the study sample alone, 7.2 million current retail brokerage IRAs would not qualify for an advisory account with any firm in the study

All firms in the study have account minimums for accessing their advisory channels. At today's account minimums, 10.7 million current retail accounts would have insufficient assets to gain access to an advisory account at their current firm. Of these, 3.5 million would have sizeable enough balances for an advisory relationship but the holders would need to switch firms to find an advisory channel with a lower minimum asset requirement. Finally, 7.2 million accounts would have insufficient assets to qualify for the advisory channel at any firm.

Based on studies of consumer behavior in similar situations, we expect significant numbers of these investors would likely drop out of the IRA market. For example, we believe that a large number of small balance investors forced to switch to a new firm to access the advisory channel would be likely to take a cash distribution rather than successfully re-invest in a new IRA. We also believe that only a portion of investors who are not able to access the advisory channel at any firm will open an online IRA, given the extensive restrictions on outreach to these clients under the proposed rule.

Box 1

Example long term investor impact estimation – illustrative only

As an example of the potential impact of this proposed rule change, we have estimated a reduction in tax advantaged retirement savings over a 20 year period using high-level assumptions. Clearly, a large number of factors come into play when considering the long term evolution of retirement savings in the U.S., and this example does not attempt to factor in all of these. Rather, it is intended to provide some sense of the potential magnitude of the impacts over time. The assumptions used are clearly stated at each stage.

As discussed in Section 4, we believe there are three possible outcomes for the 22.4 million brokerage IRAs that are included in the study sample and that would be impacted in some way by the proposed rule change:

1. We assume that each of the 11.7 million investor accounts that have sufficient assets to qualify for the advisory channel in their current firm would successfully migrate to this channel with no account holders choosing to take a distribution.
2. Prior consumer behavior studies⁸ have analyzed investor behavior when individuals leave a workplace sponsored retirement plan. We use these as a proxy for the likely

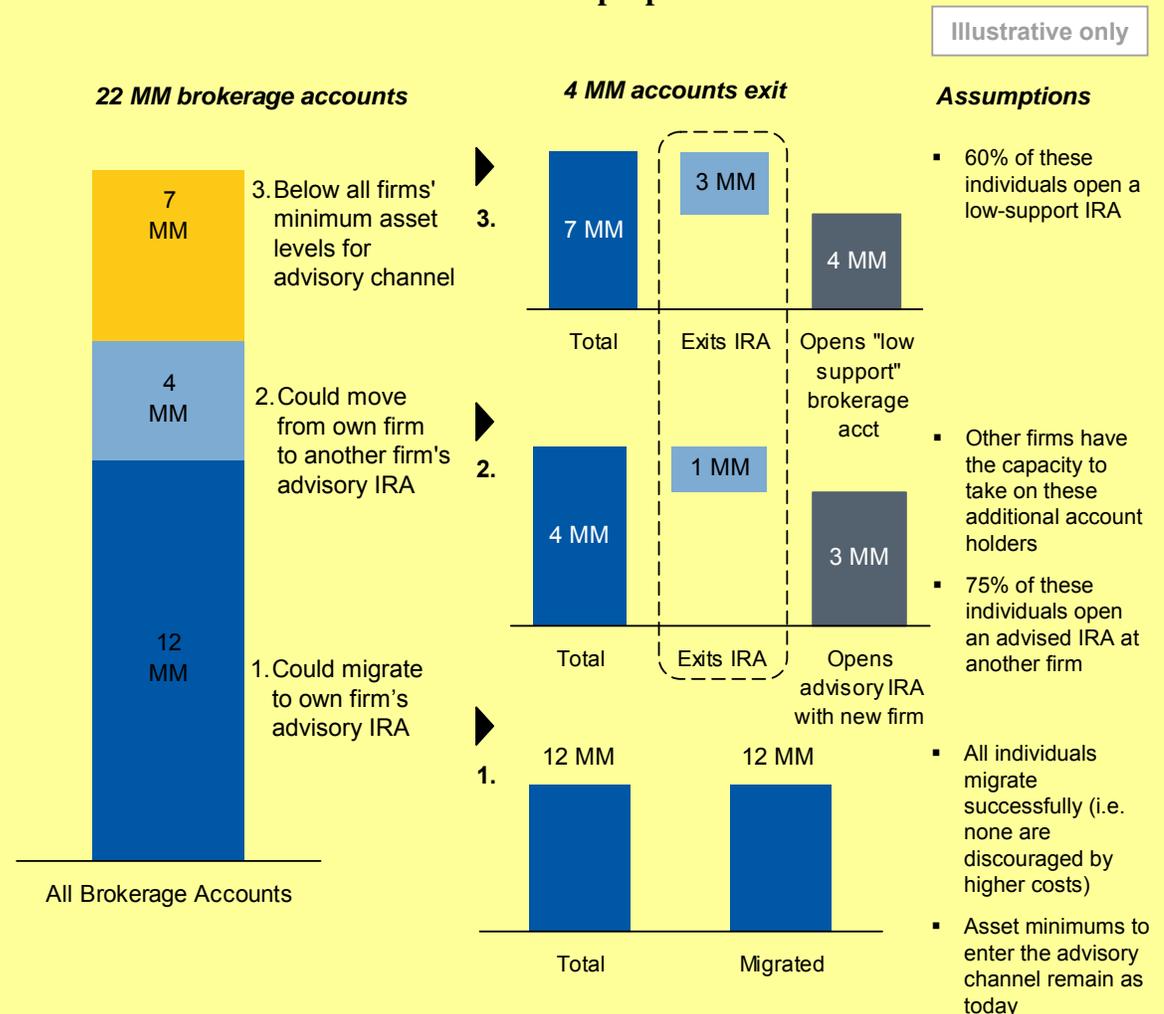
⁸ Hewitt 2009: The erosion of retirement security from cash-outs

behavior of the 3.5 million accounts that have insufficient assets to qualify for their own firm’s advisory channel but would qualify at another firm. This analysis suggests that approximately 75% may open an IRA with a new firm.

- For the remaining 7.2 million investors who do not qualify for any firm’s advisory channel, we assume that 60% open an IRA in the “low support” model. We believe that there is a high probability that the number of people who successfully open a “low support” IRA would in fact be lower (i.e. less than 60%), given the significantly reduced investment services that would be allowed under the new rule in this channel.

This estimation process results in 3.8 million IRA accounts exiting the retirement savings pool. This is illustrated in Figure 11.

Figure 11: In current sample, high-level estimates suggest that 3.8 million accounts could exit the retirement market under the proposed rule

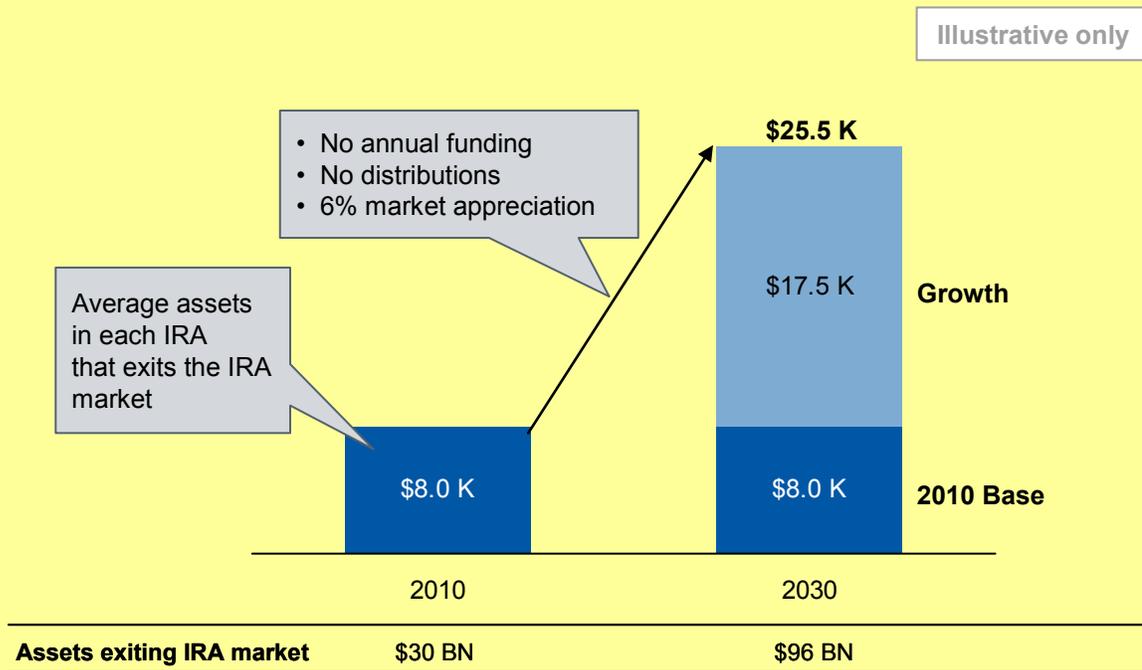


Source: Oliver Wyman assumptions and analysis of participant data, Hewitt 2009: *The Erosion of Retirement Security from Cash-Outs*

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The average assets of each IRA that exits the market would be approximately \$8,000 in this scenario. Using baseline assumptions for market appreciation as shown in Figure 12, this amount could grow to \$25,500 by 2030, suggesting a reduction of approximately \$96 BN across all IRAs that exit the market.

Figure 12: Potential lost retirement savings of \$96 BN in accounts that exit the IRA market



Source: Oliver Wyman study sample, Oliver Wyman analysis
 NYC-ZPR00111-002

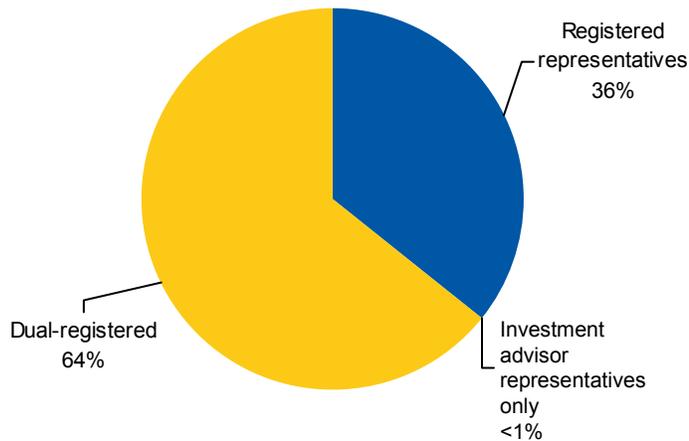
Finally, it is worth considering the impact of elimination of support from the full service brokerage model on potential future investors. In 2010, firms in the study sample opened approximately 890,000 brokerage IRA accounts with assets of less than \$10,000. If the proposed rule change were assumed to take effect at the beginning of the year and were to result in the impacts suggested in this report, we estimate as many as 360,000 brokerage IRAs would potentially no longer be opened in 2011. This estimate uses similar investor behavior assumptions to those employed for the analysis of existing small IRA account holders who would lose access to a full service brokerage model (i.e. 60% of investors would open a “low support” brokerage IRA). Given the lack of support such investors could have in navigating the complexities of opening a new IRA, we believe these are conservative assumptions. Additionally, in future years, we estimate the number of foregone new full service brokerage IRA accounts could grow to a total of approximately 8 million by 2030, assuming the number of IRA holders grows in line with population growth in the 20 plus age group.

5.2. Reduced choice of investment professional, level of investment guidance, and investment products

Investors will likely have reduced access to help and investment guidance as 36% of U.S. financial professionals in contact with clients are not currently licensed to help retail investors with their IRA account needs under the proposed new rule

As Figure 13 shows, in the study sample 37,000 current investment professionals (36% of the work force) are currently registered exclusively as registered representatives of a broker dealer, not as investment advisor representatives under the Investment Advisers Act of 1940 or dual-registered⁹.

Figure 13: Workforce by registration type, year-end 2010



Source: Oliver Wyman study sample
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Existing investors who have a personal relationship with a financial professional could find themselves forced away from this individual, regardless of their preference or relationship history. Without additional training and licensing, registered broker representatives may no longer be able to provide help and investment services to retail investors seeking to open or manage an IRA account. Not all firms have both broker dealers and investment advisor representatives, however, and it may not make sense for them to incur the cost and expense of setting up an advisory channel to support IRA accounts.

Nearly 90% of IRA investors will be impacted by the proposed rule

⁹ Industry-wide this number has been estimated by other studies at 317,000 due to the low number of dual-registered individuals in smaller firms

Over 22.4 million accounts and 17.6 million people in our sample have personally elected to save in an IRA account under a brokerage model. As discussed, some would be able to move to an advisory relationship. However, the remainder will lose the benefits of working with a financial professional and be forced to migrate to a purely “low support” brokerage model to continue their IRA retirement savings with little access to investment services, research and tools.

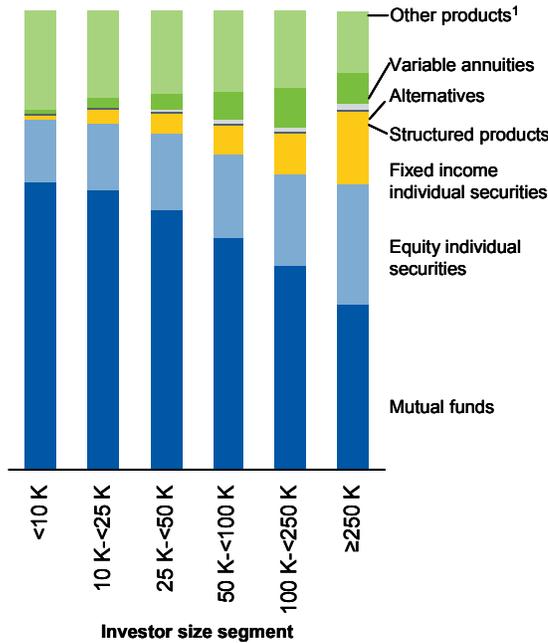
Investors will lose access to a range of product types found predominantly in brokerage IRAs today

Investors will lose access to principal transactions which they may value to provide liquidity to obtain certain investments at favorable prices. In addition, a range of product choices currently offered predominantly in brokerage IRA relationships may no longer be able to be offered, such as some variable annuities, proprietary products to which clients may want specific access, unique structured products, as well as a wide array of third-party solutions available at those firms.

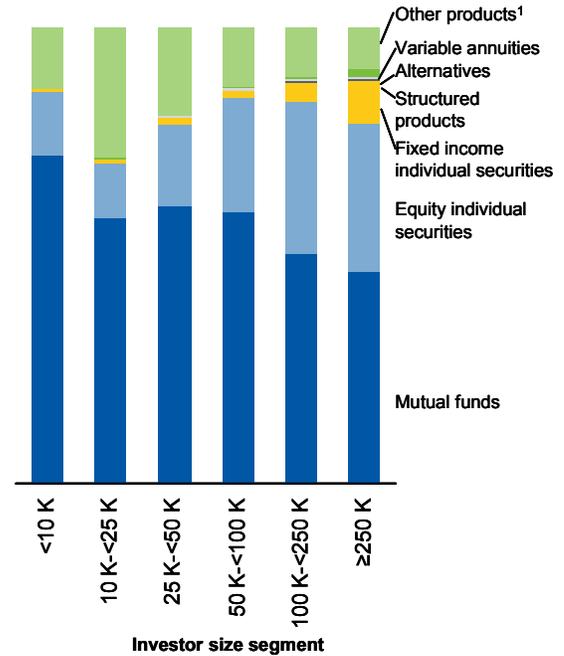
Figure 14: Asset allocation comparison shows investors favor brokerage accounts for holding individual fixed income securities and variable annuities

Allocation of assets (%) by IRA account size and model, year-end 2010

Asset allocation in brokerage IRA accounts
Allocation of assets (%) by IRA account size, year-end 2010



Asset allocation in advisory IRA accounts
Allocation of assets (%) by IRA account size, year-end 2010



Source: Oliver Wyman study sample

1. Includes cash, money market funds, fixed and deferred annuities, etc.

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5.3. Increased cost

Based on the study sample, a significant share of brokerage accounts may be able to continue receiving investment help and guidance by moving to an advisory relationship. Such investors would then face increased annual costs, due to the higher cost of servicing and maintaining these accounts. As shown in Figure 15, investors would pay an average of 73% to 196% more in direct costs in a fee-based advisory model.

Figure 15: Fee-based advisory accounts are more expensive for investors of all account sizes

Direct per account costs¹ for brokerage and fee-based accounts, 2010

	10K-<25K	25K-<50K	50K-<100K	100K-<250K	≥250K
Brokerage	\$80	\$135	\$230	\$455	\$1,070
Advisory	\$135	\$275	\$555	\$1,245	\$3,165
% cost difference (advisory – brokerage)	73%	106%	142%	173%	196%

Source: Oliver Wyman study sample

1. Excludes marketing and distribution, shareholder services, and other fees not directly paid by investors

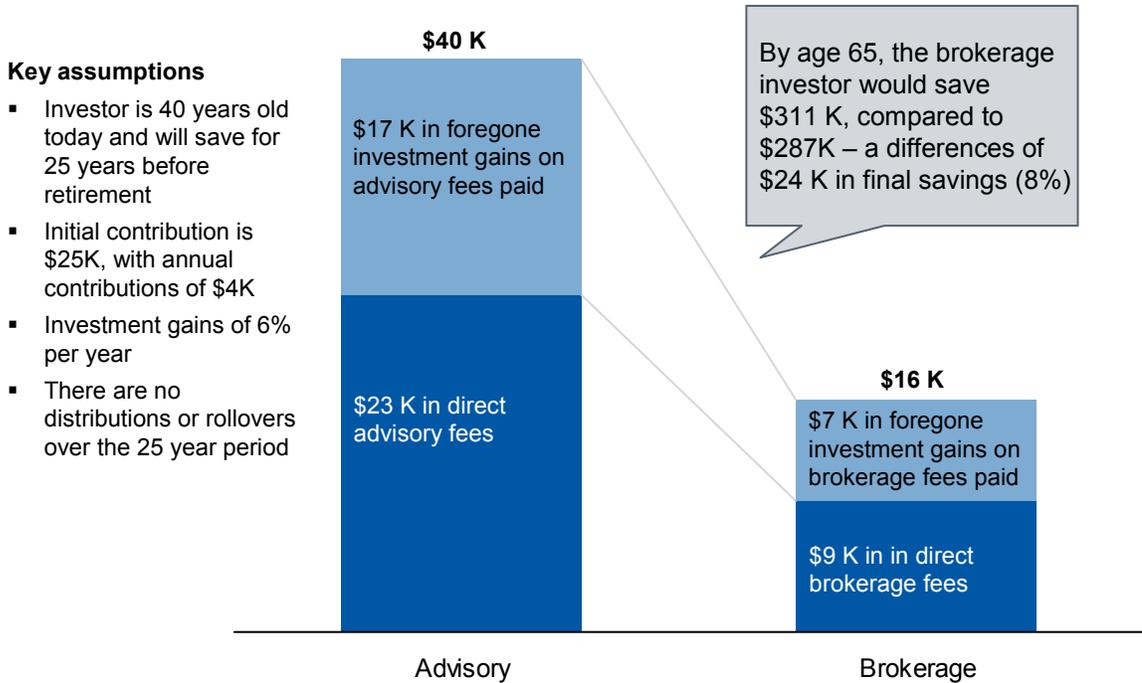
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In addition to direct costs paid by investors, firms may also receive marketing, distribution, shareholder services, and other fees in connection with providing brokerage IRA services not paid directly by investors. Firms vary in whether they receive such fees and how they account for them. If the Department of Labor’s proposal were to be adopted as proposed, such fees would likely be restricted or eliminated for many IRAs. To the extent such fees are considered, the cost difference between the brokerage and advisory IRA models would narrow, though brokerage would continue to be less expensive across all account sizes in the study sample.

These increased investment costs would serve as a drag on long-term investment gains, and therefore on the ultimate retirement savings available to impacted account holders. Figure 16 illustrates this point for a hypothetical 40-year old individual with \$25,000 in an IRA and 25 years of saving before retiring at age 65.

Figure 16: The impact on retirement savings of the higher-cost advisory model is compounded over time

Comparison of difference in direct fees paid and foregone investment gains over 25 years for a hypothetical investor under brokerage and fee-based advisory models



Source: Oliver Wyman study sample, Oliver Wyman analysis
 Note: Cost of advisory and brokerage accounts based on actual direct costs observed in study sample, of 0.60%-0.80% for advisory accounts and 0.20%-0.50% for brokerage accounts, varying by wealth segment
 Costs exclude marketing and distribution, shareholder services, and other fees not directly paid by the investor – the cost differential between the two models is still significant if these fees are included

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In this illustrative example, the IRA investor would have an additional \$24,000 (8%) of retirement savings available at age 65 under the brokerage model, in comparison to the advisor model.

6. Conclusions

The Department of Labor’s proposed rule change is motivated by a laudable objective: to ensure a high standard of care for retirement plan participants and account holders with regard to the receipt of services and investment guidance, amid an increasingly complex financial marketplace. However, we find that the proposed Department of Labor “fiduciary” definition rule is likely to have serious negative and unintended effects on the very individuals the change is supposed to help.

Based on the unprecedented collection of data on IRA account holders assembled to support our analysis, we conclude that the proposed rule will disproportionately

negatively affect small balance IRA investors – those individuals most in need of support in reaching their retirement goals. The proposed rule is likely to change an important avenue through which retail investors save for retirement, denying millions of current and future IRA investors access to professional investment help and investment services, limiting choice of how they receive and pay for investment services, and increasing overall costs for such support when available.

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**ACCESS TO CALL CENTERS AND BROKER
DEALERS AND THEIR EFFECTS ON
RETIREMENT SAVINGS**

Prepared by
Quantria Strategies, LLC

Final
April 9, 2014

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EXECUTIVE SUMMARY

RE-PROPOSED REGULATIONS THAT ARE ANTICIPATED FROM THE DEPARTMENT OF LABOR (DOL) ARE GENERALLY EXPECTED TO CREATE FIDUCIARY RESPONSIBILITY FOR FINANCIAL SERVICE PROVIDERS THAT WILL LIMIT THE ACCESS TO ASSISTANCE PROVIDED BY CALL CENTERS AND BROKER-DEALERS WHEN TERMINATING EMPLOYEES FACE PLAN DISTRIBUTION DECISIONS. LIMITING ACCESS TO THIS ASSISTANCE COULD INCREASE ANNUAL CASH OUTS OF RETIREMENT SAVINGS FOR EMPLOYEES TERMINATING EMPLOYMENT BY \$20 – 32 BILLION. THESE WITHDRAWALS COULD REDUCE THE ACCUMULATED RETIREMENT SAVINGS OF AFFECTED EMPLOYEES BY 20 TO 40 PERCENT.

- If expected DOL re-proposed regulations apply the fiduciary standard to advice to retirement plan participants concerning their distribution options, millions of participants could lose access to call center and broker-dealer assistance upon job termination. Approximately 50 million job terminations occur each year among wage and salary workers in the United States.¹ Terminating employees often need to make decisions about their retirement savings, including what to do with retirement savings accumulated in the former employer's retirement savings plan. Our empirical model indicates that losing access to financial assistance at job termination could have significant impacts on long-term retirement savings; our results found that retirement savings balances are 33 percent higher for individuals who have access to financial assistance. While beyond the scope of this study, we note our results suggest that reduced access to financial assistance generally could have broad, long-term effects on plan participants that are not limited to plan participants who terminate employment.²
- According to a 2011 survey, 42 percent of terminating employees take a cash distribution from their retirement savings, 29 percent roll their retirement savings to another plan or an IRA, and 29 percent leave their assets in the employer's plan.³ Terminating employees cashed out approximately 7.3 percent of their total retirement assets. Further, these distributions are more likely to occur among individuals who (1) have a low account balance, (2) are under age 30, or (3) have lower wages. Higher cash-out rates are also an issue for African-Americans and Hispanics.
- Employees are less likely to take cash withdrawals of their retirement savings if they discuss their distribution options with a call center or broker-dealer upon job termination. One company found that terminating employees with account balances between \$35,000 and \$50,000 are approximately 3.2 times less likely to cash out their retirement savings if they receive a call from a licensed representative of the company compared to similarly situated terminating employees who only receive written communications.
- DOL's re-proposed regulations may eliminate access to call centers and broker-dealer assistance with respect to distribution advice. A recent Government Accountability Office (GAO) report suggests that terminating employees often receive guidance and marketing that could favor IRA

¹ Hathaway, Kendra C. *Job openings continue to grow in 2012, hires and separations less so*. Bureau of Labor Statistics, JOLTS Publications, JOLTS Annual Story, 2012.

² The data used in our model do not specifically examine the effect of financial assistance on cash-out behavior, but rather look at the overall effects of financial assistance on retirement savings.

³ *Leakage of Participants' DC Assets: How Loans, Withdrawals, and Cashouts Are Eroding Retirement Income, 2011*. AON Hewitt, 2011. The study found these percentages were consistent with pre-economic downturn numbers.

rollovers.⁴ However, very importantly, the GAO also noted the fears of fiduciary liability could inhibit communications with employees and the provision of information regarding distribution options. Inhibiting these communications creates a great risk to retirement savings – that terminating employees will take cash distributions instead of leaving their assets in their employer’s plan or rolling over the assets to another plan or IRA. From a retirement security perspective, retaining the assets in either an employer plan or IRA is preferable to cashing out.

Davis & Harman, LLP commissioned this report on behalf of a coalition of financial services organizations that provide retirement services to millions of Americans.

⁴ United States Government Accountability Office. *401(K) PLANS. Labor and IRS Could Improve the Rollover Process for Participants.* GAO-13-30, March 2013.

I. FINDINGS AND OVERVIEW OF RESEARCH

A. FINDINGS

- Employees need to make numerous decisions about their retirement savings, including whether and when to participate in an employer-sponsored retirement plan or IRA, how much to contribute, how to invest the assets in the plan or IRA, and when and how to take a distribution. A substantial body of research shows that Americans frequently lack the basic financial literacy needed to make decisions about their retirement savings. This lack of financial literacy causes employees to make suboptimal decisions concerning their retirement savings.
- One of the critical “choke points” in the retirement savings process occurs when an employee changes jobs or retires; at this point, an individual must decide what to do with retirement savings accumulated in a former employer’s plan. The job termination “choke point” will occur multiple times during an employee’s working career; on average, approximately 50 million job terminations occur each year among wage and salary workers in the United States.⁵ In 2012, half of all wage and salary workers in the United States had been with an employer for less than 4.6 years.⁶
- Many people do not understand the long-term consequences of taking cash withdrawals of retirement savings at job termination. If a terminating employee decides to withdraw retirement savings and not roll the assets over to an IRA or another qualified plan, the employee loses not only the amount of the withdrawn assets, but also the future earnings on these amounts (i.e., the benefits of interest compounding). Furthermore, if an employee is younger than 59½ years old, she generally would also pay an additional 10 percent tax on the taxable portion of any withdrawal that is not rolled over.
- According to a 2011 survey, 42 percent of employees take a cash distribution from their retirement savings at job termination, 29 percent roll their retirement savings to another plan or an IRA, and 29 percent leave their assets in the employer’s plan.⁷ The cash-out rate varies by account size; the survey found a 75 percent cash-out rate for participants with less than \$1,000 in their account and a 10 percent cash-out rate for participants with at least \$100,000 in their account. Terminating employees cashed out approximately 7.3 percent of their total retirement assets.
- Cash-outs are more likely to occur among individuals who (1) have a low account balance, (2) are under age 30, or (3) have lower wages. Higher cash-out rates are also an issue for African-Americans and Hispanics.
- A recent General Accountability Office (GAO) report suggested that employees who change jobs often receive guidance and marketing from service providers’ call centers encouraging them to roll their retirement savings into IRAs rather than keeping the

⁵ Hathaway, Kendra C. *Job openings continue to grow in 2012, hires and separations less so*. Bureau of Labor Statistics, JOLTS Publications, JOLTS Annual Story, 2012.

⁶ Ibid.

⁷ *Leakage of Participants’ DC Assets: How Loans, Withdrawals, and Cashouts Are Eroding Retirement Income, 2011*. AON Hewitt, 2011. The study found these percentages were consistent with pre-economic downturn numbers.

savings in a 401(k) plan.⁸ However, this report ignores the fact that the greatest risk to retirement savings is that employees will take a cash distribution upon job termination. From a retirement security perspective, retaining the assets in either an employer plan or an IRA is preferable to cashing out.

- Employees who interact with a call center or broker-dealer to help them understand their options upon job termination are less likely to take cash withdrawals of their retirement savings. We contacted a number of financial services companies about the interactions between terminating employees and call centers. One company found that terminating employees with account balances between \$35,000 and \$50,000 are approximately 3.2 times less likely to cash out their retirement savings if they receive a call from a licensed representative of the company compared to similarly situated terminating employees who only receive written communications.
- These statistics are consistent with our analysis of a Department of Labor (DOL) pilot survey conducted as part of the Rand American Life Panel. Our empirical models suggest that access to financial assistance results in plan balances that are 33 percent higher than for individuals who do not have access to financial assistance.⁹
- DOL's re-proposed regulations may eliminate access to call centers and broker-dealer assistance with respect to distribution advice. If this happens, the cash-out rates of employees terminating employment will increase and retirement savings will decline in both the short- and long-term. We estimate that eliminating the availability of call centers and reducing broker-dealer assistance upon job termination will increase annual cash outs of retirement savings by an additional \$20 – 32 billion. Over the long run, these cash outs will result in a significant reduction in overall retirement savings; our estimates indicate that these withdrawals could reduce the ultimate retirement savings of affected individuals by 20 to 40 percent.

B. OVERVIEW OF RESEARCH

DOL is expected to issue re-proposed regulations addressing the issue of fiduciary liability with respect to retirement savings plans. These re-proposed regulations may limit the ability of financial services companies to assist individuals who are terminating employment with respect to their distribution options for their retirement savings assets. This limitation would arise because DOL's prohibited transaction rules would generally preclude any advice from a financial services company, even if the advice is in the best interest of the individual, unless the DOL provides comprehensive exemptions from such rules. Accordingly, we examined the potential effects on cash outs of retirement savings when employees terminate employment and the long-term implications for overall retirement savings if the re-proposed regulations apply the fiduciary standard to assistance with respect to distribution options without the prohibited transaction exemptions needed to permit the kind of assistance that is currently being provided to terminating employees by call centers and broker dealers.

⁸ United States Government Accountability Office. *401(k) Plans. Labor and IRS Could Improve the Rollover Process for Participants*. GAO-13-30, March 2013.

⁹ The survey does not specifically examine the effect of financial assistance on cash-out behavior, but rather looks at the overall effects of financial assistance on retirement savings.

A substantial body of research in the United States finds that financial literacy presents a significant problem for retirement savings adequacy. Individuals tend to make suboptimal decisions concerning their retirement savings and the problem is particularly acute for individuals in particular demographic groups, including individuals with lower income, individuals with less education, the young, and the old (retired or near retired). Women, African-Americans, and Hispanics also face unique challenges in this area.

Research has also shown that consulting with a financial planner or advisor positively correlates with retirement savings balances, suggesting that access to a financial planner or advisor will improve retirement savings outcomes. However, most of the research focuses on individuals who hire a paid financial planner; these individuals are likely to have characteristics associated with positive savings behavior (e.g., such characteristics include higher income and higher educational attainment). Generally, individuals with these characteristics have a greater propensity to save notwithstanding the consultation with a financial planner or advisor.

However, none of the research to date has explored the outcomes associated with the assistance provided by call centers or broker dealers to a retirement plan participant at termination of employment. Generally, this assistance occurs when an individual contacts a call center or broker-dealer associated with the employer's retirement savings plan; these contacts may also occur through a proactive contact by a call center. For a terminating employee, these types of contacts assist the employee by providing the various options with respect to his or her retirement savings and often counsel the employee against cashing out the retirement savings.

This study examines the possible correlation between access to a call center or broker-dealer and the short- and long-term accumulation of retirement savings for employees who terminate employment. Our analysis expands on existing research by considering the effects on retirement savings if terminating employees should lose access to call centers or broker dealers.

The study relies on data from the Rand American Life Panel (ALP), which follows approximately 6,000 individuals who participate in occasional, on-line surveys. The approximately 350 surveys conducted to date provide data on financial decision-making, access to financial advice, financial literacy, income, retirement savings, demographics, and such other topics as self-reported health and wellbeing. This study uses a regression-based model of total retirement savings balances to attempt to isolate the effect of financial advice, controlling for other variables that may also be important in determining the size of total retirement savings.¹⁰

The study also utilizes confidential data provided by several large financial service companies concerning the volume and outcome of call center assistance provided to employees with respect to their retirement savings. This additional data helps to isolate the potential effects of call center assistance at employment termination and provides additional support for the results of the regression analysis.

¹⁰ See Appendix A for a technical discussion of the empirical analysis of the ALP survey results. Because the ALP does not specify the type of financial assistance provided, it does not allow a distinction between the use of a paid financial advisor for retirement savings assistance and consultation with a call center or broker dealer offered as a routine service to employees participating in an employer-sponsored retirement savings plan. Further, the ALP does not distinguish between general assistance and specific assistance provided when an employee terminates employment with an employer.

II. RETIREMENT SAVINGS AND FINANCIAL LITERACY

A. AMERICAN WORKERS LACK FINANCIAL LITERACY

Employees need to make numerous decisions about their retirement savings, including whether and when to participate in an employer-sponsored retirement plan or IRA, how much to contribute, how to invest the assets in the plan or IRA, and when and how to take a distribution. A substantial body of research shows that Americans frequently lack the basic financial literacy needed to make decisions about their retirement savings. This lack of financial literacy causes employees to make suboptimal decisions concerning their retirement savings.

A substantial body of research has explored the causes of suboptimal retirement savings in the United States. One of the problems commonly identified in the literature is that many U.S. workers lack financial literacy, which means that they lack basic understanding of key financial concepts, such as the benefits of interest compounding. Other research has focused on the effects of access to financial advice and financial education programs as a way to counter lack of financial literacy.

Across all age groups, individuals lack essential knowledge of basic financial concepts, including interest compounding, the effects of inflation, and diversification of risk.¹¹ In multiple surveys and studies, the research shows that a significant percentage of U.S. workers (1) cannot answer correctly the most simple multiple choice questions on issues of basic financial literacy, (2) fail to plan adequately for retirement, (3) consistently underestimate the amount of retirement savings they will need, and (4) make decisions, such as cashing out their retirement savings prior to retirement age, that adversely impact their long-term retirement savings.¹²

Amromin et al reviewed the literature on financial literature and concluded that the surveys and studies varied significantly in content and sample population, but generally agreed on the following:

“(1) a large proportion of consumers are not financially literate, even among the wealthiest and most educated population segments,
(2) financial literacy rates vary consistently by demographic groups, tending to be high for those with more wealth and education, for men (although results vary), and for whites (in the U.S.), and
(3) financial illiteracy leads to welfare-reducing financial behavior and outcomes.”¹³

¹¹ See, for example, Lusardi, Annamaria and Olivia S. Mitchell. *Financial Literacy and Retirement Planning in the United States*, February 1, 2011. Lusardi, Annamaria and Olivia S. Mitchell. *Financial Literacy and Planning: Implications for Retirement Wellbeing*. University of Michigan Retirement Research Center, MRRC Working Paper n. 2006-144.

¹² The list of references at the end of this paper contains multiple sources for research relating to financial literacy and retirement saving.

¹³ Amromin, Gene, Itzhak Ben-David, Sumit Agarwal, Souphala Chomsisenphet, and Douglas D. Evanoff. *Financial Literacy and the Effectiveness of Financial Education and Counseling: A Review of the Literature*. Accessed at: http://www.chicagofed.org/digital_assets/others/region/foreclosure_resource_center/more_financial_literacy.pdf.

Low levels of financial literacy present particularly acute problems for certain demographic groups, such as individuals with low education. Concerns have also been raised about the challenges facing women, African-Americans, and Hispanics.¹⁴

These challenges translate to average account balances in 401(k) plans that are significantly lower for African-Americans and Hispanics than other demographic groups.¹⁵ Table 1 shows average account balance, by salary range, for African-Americans, Hispanics, and whites participating in a 401(k) or 403(b) plan of 60 of the largest business and nonprofit organizations in the United States. Across all salary ranges, African-Americans and Hispanics have lower average account balances than their white counterparts.

Salary	African-American		Hispanic		White	
	2007	2010	2007	2010	2007	2010
\$0 – \$29,999	\$7,518	\$7,557	\$7,930	\$8,949	\$13,836	\$14,563
\$30,000 – \$59,999	\$28,169	\$24,505	\$28,727	\$27,823	\$44,546	\$42,720
\$60,000 – \$89,999	\$71,630	\$68,343	\$77,991	\$76,031	\$101,535	\$98,290
\$90,000 – \$119,999	\$122,208	\$132,222	\$125,520	\$138,274	\$164,897	\$182,061
\$120,000 and over	\$173,490	\$201,585	\$167,781	\$206,007	\$243,115	\$285,341

Source: *401(k) Plans in Living Color. A Study of 401(k) Savings Disparities Across Racial and Ethnic Groups.* The Ariel/Aon Hewitt Study 2012.

At the lowest salary levels, the average account balances of African-Americans and Hispanics are only approximately 60 percent of the average for whites. The percentage disparity becomes smaller as salaries increase, but even at the highest salary levels, the average account balances of African-Americans and Hispanics tend to be approximately 70 percent of the average for whites. While a variety of factors (e.g., lower participation and contribution rates) account for these disparities, preretirement cash-outs of retirement savings represents one significant factor (discussed in greater detail below) affecting account balances for all workers, but particularly for minority and ethnic groups.

B. JOB TURNOVER CREATES RETIREMENT SAVINGS “CHOKE POINT”

One of the critical “choke points” in the retirement savings process occurs when an employee changes jobs or retires; at this point, an individual must decide what to do with retirement savings accumulated in a former employer’s plan. The job termination “choke point” will occur multiple times during an employee’s working career; on average, approximately 50 million job terminations occur each year among wage and salary workers in the United States. In 2012, half of all wage and salary workers in the United States had been with an employer for less than 4.6 years.

From a retirement savings perspective, financial illiteracy causes workers to make bad decisions at important “choke points” in the retirement savings process. We define choke points as critical points in an individual’s working life when savings behavior may change. One of the critical

¹⁴ *Ibid*, at p. 12.

¹⁵ *401(k) Plans in Living Color. A Study of 401(k) Savings Disparities Across Racial and Ethnic Groups.* Ariel Education Initiative, Aon Hewitt, Joint Center on Political and Economic Studies, and The Raben Group, 2012.

“choke points” in the retirement savings process occurs when an employee changes jobs or retires; at this point, an individual must decide what to do with retirement savings accumulated in a former employer’s plan. At this time, an individual may dis-save (take a cash out of retirement savings) or temporarily or permanently stop saving for retirement. Thus, decisions made at the job termination choke point affect the ability of an individual to accumulate adequate savings for retirement security.

More than half of all employers offer their employees the ability to defer current wages and salary into a defined contribution retirement account (often a 401(k) plan).¹⁶ These accounts typically offer an employer matching contribution in addition to the employee deferrals. In 2011, employees contributed approximately \$186 billion and employers provided matching contributions of an additional \$122 billion.¹⁷

One of the advantages of a defined contribution plan is that it provides portability for employees upon job change. An employee who terminates employment typically has several options with respect to his or her accumulated retirement savings; the individual can:

- leave the retirement savings in the old employer’s plan;
- transfer or roll over their retirement savings to a new employer’s plan or an IRA; or
- withdraw the accumulated retirement savings and use them for nonretirement purposes.

Plan portability can be important because of the mobility of the U.S. workforce. On average, approximately 4 million wage and salary workers in the United States separate from service with an employer each month for approximately 50 million job terminations per year.¹⁸ Most workers will change jobs multiple times during their working careers. While it is difficult to estimate the number of job changes that individuals will have during their working career, one study (the National Longitudinal Survey of Youth 1979) tracked early Baby Boomers (ages 45-53 in 2010-2011) and found that, on average, this group had held 11.3 jobs from ages 18-46.¹⁹

The median job tenure for wage and salary workers in the United States was 4.6 years in 2012, meaning that half of all wage and salary workers had been with an employer for less than 4.6 years.²⁰ Job turnover rates are particularly high for some minority and ethnic groups with 51.5 percent of African-Americans, 56.2 percent of Hispanics, and 53.4 percent of Asians working for their current employer for less than five years.²¹ Less than 30 percent (29.2) of the total wage and salary workforce has been employed with their current employer for 10 or more years.²²

¹⁶ Refer to Copeland, Craig, Ph.D., *Retirement Plan Participation: Survey of Income and Program Participation (SIPP) Data, 2012*, Employee Benefits Research Institute. The study indicates that, based on the latest Survey of Income and Program Participation data from the U.S. Census Bureau, 61 percent of all workers over age 16 had an employer that sponsored a pension or retirement plan for any of its employees in 2012. The percentage of workers participating in a plan was 46 percent in 2012.

¹⁷ U.S. Department of Labor, Employee Benefit Security Administration, Private Pension Plan Bulletin, *Abstract of 2011 Form 5500 Annual Reports*, June 2013..

¹⁸ Hathaway, Kendra C. *Job openings continue to grow in 2012, hires and separations less so*. Bureau of Labor Statistics, JOLTS Publications, JOLTS Annual Story, 2012.

¹⁹ U.S. Department of Labor, Bureau of Labor Statistics. *Number of Jobs Held, Market Activity, and Earnings Growth Among the Youngest Baby Boomers: Results From a Longitudinal Survey*. USDL-12-1489, July 25, 2012

²⁰ *Employee Tenure in 2012*. Bureau of Labor Statistics, Economic News Release, September 18, 2012.

²¹ *Ibid.*

²² *Ibid.*

The statistics suggest that job turnover represents a pivotal point in the retirement savings process when employees must make decisions about what to do with the retirement savings they have accumulated with their employer. This “choke point” occurs multiple times during an average working career. Withdrawals from retirement savings that occur upon job change represent not only the loss of the amount of accumulated savings, but also the loss of the benefits of compounding that occurs when these amounts are withdrawn from retirement savings.

C. CASHOUTS OF RETIREMENT SAVINGS ERODE LONG-TERM RETIREMENT SECURITY

If a terminating employee decides to withdraw retirement savings and not roll the assets over to an IRA or another qualified plan, the employee loses not only the amount of the withdrawn assets, but also the future earnings on these amounts (i.e., the benefits of interest compounding).

U.S. retirement assets totaled \$20.9 trillion as of June 30, 2013.²³ Estimates indicate that preretirement withdrawals from retirement savings total from \$70 to \$104 billion each year.²⁴ While these withdrawals represent a small percentage of total retirement assets (0.34 to 0.50 percent), even modest withdrawals from individual accounts can reduce the ability of individuals to attain adequate retirement savings. Further, increases in the cash-out rate could result in significant declines in retirement security in the United States.

Preretirement withdrawals (commonly referred to as leakage) from retirement savings can occur in a number of ways. Loans, in-service withdrawals (for hardships and life events), and distributions that occur at (or following) job change are three forms of leakage that diminish retirement savings balances.

This analysis focuses on withdrawals at job termination, which affect retirement savings in two ways. First, if the individual does not replace or rollover the retirement savings to another employer plan or an IRA, the withdrawals will reduce the individual’s overall account balance. Second, even if the individual replaces the funds at a subsequent time, the individual loses the benefits of the tax-deferred earnings on the amounts withdrawn and the compounding effects of interest accumulation.

A recent study found that, for tax year 2010, distributions from qualified retirement plans totaled \$1,281 billion, \$241 billion of which went to taxpayers under age 55.²⁵ Nearly half of this amount, \$104.3 billion, was subject to tax and, in some cases, subject to early withdrawal penalties (see Graph 1). Recognizing the inclination of many individuals not to leave portable retirement funds with a former employer, more than \$100 billion was rolled over (directly or indirectly) to other qualified accounts.

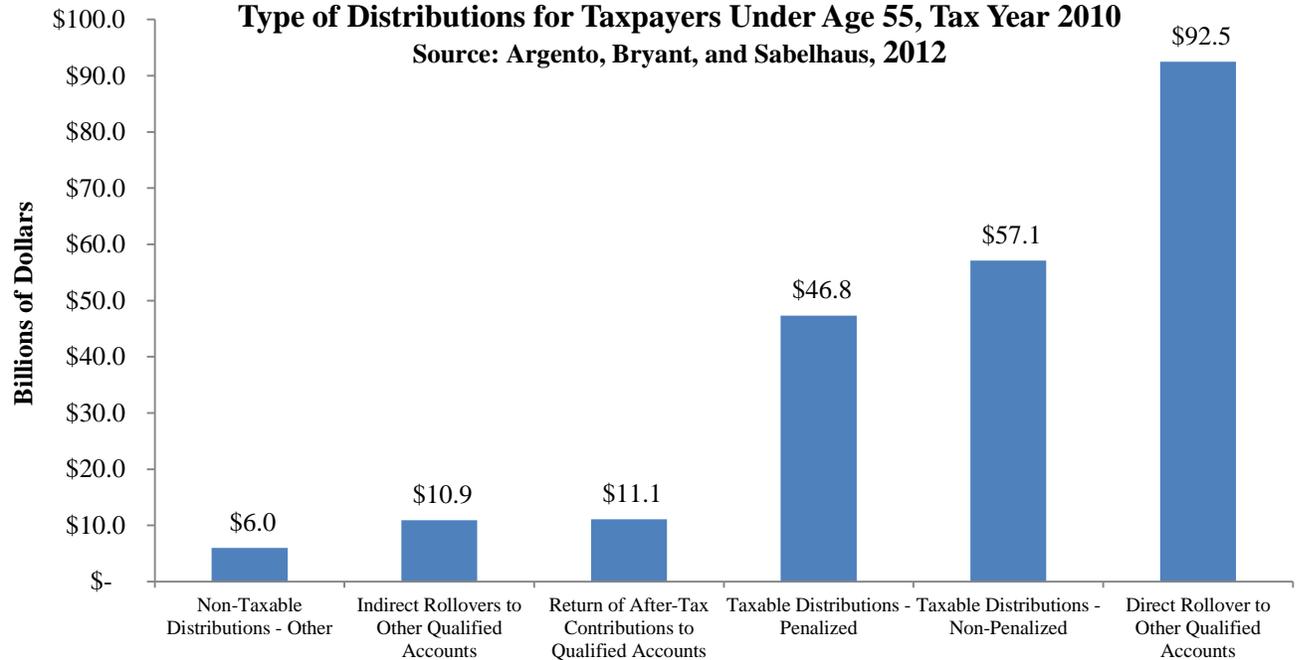
²³ Investment Company Institute, Research and Statistics. *Retirement Assets Total \$20.9 Trillion in Second Quarter 2013, September 30, 2013*. Accessed at: http://www.ici.org/research/retirement/retirement/ret_13_q2.

²⁴ Refer to Fellowes, Matt and Katy Willemin, *The Retirement Breach in Defined Contribution Plans Size, Causes, and Solutions*, HelloWallet, January 2013 and Argento, Robert and Victoria L. Bryant, John Sabelhaus, *Early Withdrawals from Retirement Accounts During the Great Recession*, prepared for presentation at the November, 2012, National Tax Association annual meetings, November 2012.

²⁵ Refer to Argento, Robert and Victoria L. Bryant, John Sabelhaus, *Early Withdrawals from Retirement Accounts During the Great Recession*, prepared for presentation at the November, 2012, National Tax Association annual meetings, November 2012.

Graph 1 Total Distributions from Retirement Accounts, by Selected Type of Distributions for Taxpayers Under Age 55, Tax Year 2010

Source: Argento, Bryant, and Sabelhaus, 2012

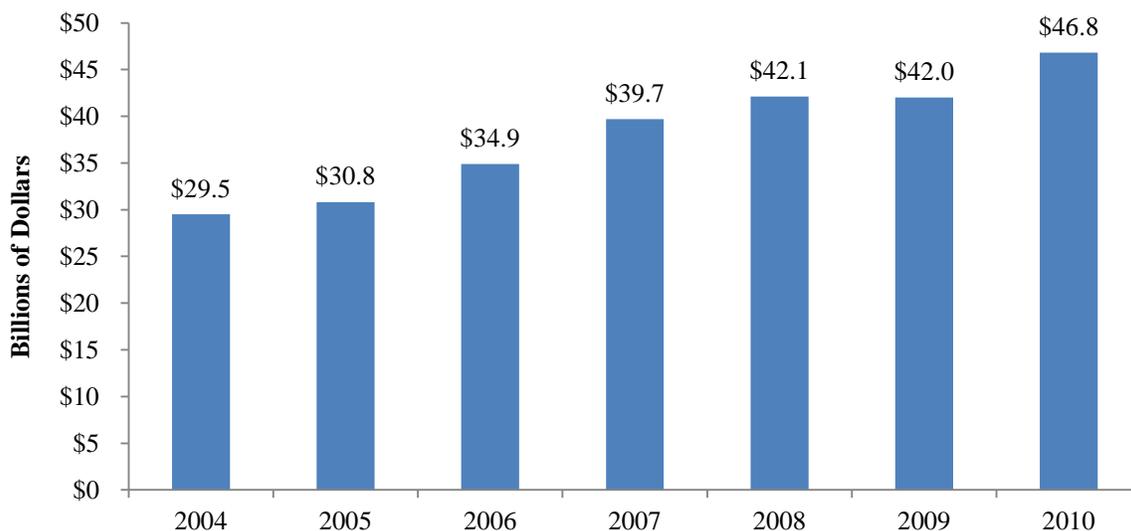


The study estimated that nearly 25 percent of all taxpayers *younger than age 55 with current pension coverage* (or retirement balances from past contributions) had a gross distribution in 2010. Among those taxpayers with a gross distribution, approximately 67 percent of the taxpayers had a taxable distribution, and about 40 percent had a penalized distribution. With respect to the dollar amounts, approximately 43 percent of the gross distribution amounts were subject to tax and nearly 20 percent of the gross distributions (approximately \$46.8 billion) were subject to early withdrawal penalties. (Refer to Graph 1.)²⁶ Graph 2 shows the annual penalized distributions for taxpayers under age 55, for 2004 to 2010.

²⁶ Note there are modest discrepancies in the data reported in the 2010 Argento et al paper. For instance, the penalized amount for 2010 is listed in Table 1 is \$47.3 billion, but in Table 3, this amount is listed as \$46.8 billion. However, the discrepancy is small enough to be irrelevant for the purposes of this study. For purposes of our study, we report the \$46.8 billion figure.

Graph 2 Total Distributions from Retirement Accounts Subject to a Tax Penalty, for Taxpayers Under Age 55

Source: Argento, Bryant, and Sabelhaus, 2012



When workers make a job change (either voluntarily or involuntarily terminate employment), they have several options available with respect to their retirement assets – generally, they may keep the assets in the original employer’s plan, roll over the assets to an IRA or to a retirement savings plan of a new employer, or cash out the balance.

According to a 2011 survey, 42 percent of employees take a cash distribution of their retirement savings at job termination, 29 percent roll their retirement savings to another plan or an IRA, and 29 percent leave their assets in the employer’s plan.²⁷ The cash-out rate varies by account size; the survey found a 75 percent cash-out rate for participants with less than \$1,000 in their accounts and a 10 percent cash-out rate for participants with at least \$100,000 in their accounts. Total assets cashed out represented 7.3 percent of total retirement savings assets of terminating employees.

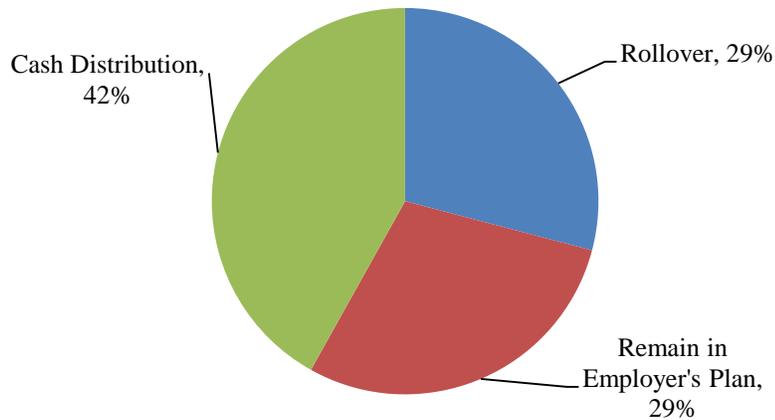
Thus, empirical research indicates that nearly half of all workers take cash distributions when terminating employment.²⁸ On a plan-asset weighted basis, cash distributions in the 2011 survey represented 7.3 percent of the total amounts available at employment termination, with 54.7 percent of assets remaining in the employer’s plan and 38 percent of assets rolled over to another employer retirement plan or an IRA (refer to Graph 3).

²⁷ *Leakage of Participants’ DC Assets: How Loans, Withdrawals, and Cashouts Are Eroding Retirement Income 2011.* Aon Hewitt, 2011.

²⁸ One survey indicated that this percentage could be as high as 68 percent, although the data may be out of date. Refer to Moore, James H. and Leslie A. Muller, *An analysis of lump-sum pension distribution recipients*, Monthly Labor Review, May 2002.

Graph 3 Treatment of Retirement Plan Assets, after Employment Terminations, Percentage of Employees

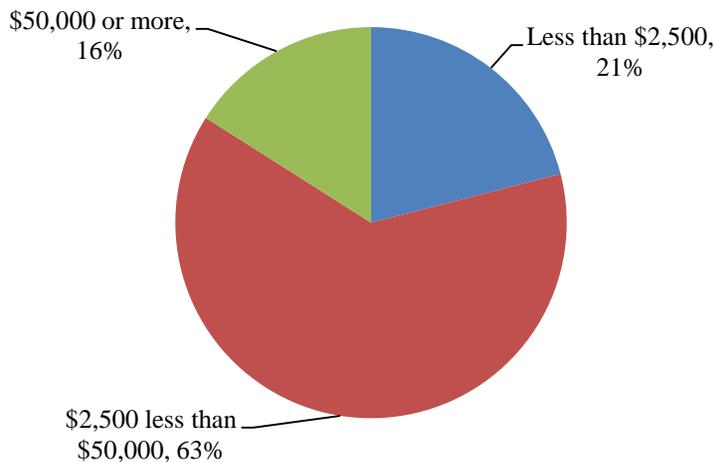
Source: Aon Hewitt Survey, 2011



Cashing out tends to be the most prevalent behavior with average distributions of \$32,219 (in 2006 dollars).²⁹ The following graph (Graph 4) displays the range of distribution amounts for individuals taking a lump-sum distribution when changing jobs.

Graph 4 Lump-Sum Distributions at Job Change, by the Size of the Distribution

Source: EBRI Notes, January 2009



²⁹ EBRI Notes, Lump-Sum Distributions at Job Change, Vol. 30, No. 1, January 2009.

D. CASH-OUTS MORE LIKELY AMONG CERTAIN GROUPS

Cash-outs are more likely to occur among individuals who (1) have a low account balance, (2) are under age 30, or (3) have lower wages. Higher cash-out rates are also an issue for African-Americans and Hispanics.

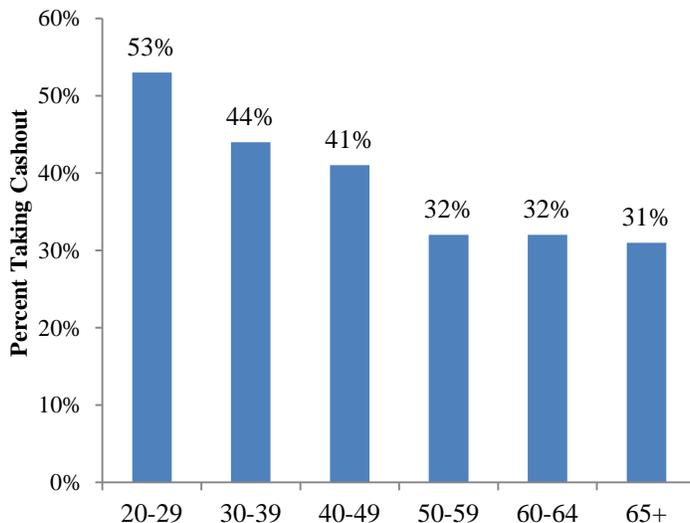
Certain participant characteristics provide an indicator of the likelihood that employees will cash out their retirement savings at job change. These characteristics relate to the amount of retirement savings accumulated, as well as certain demographic characteristics, including the employee's age, income, and race or ethnicity.

1. Account Balances – The likelihood that an employee will cash out a retirement account after terminating employment correlates negatively with the employee's account balance. As an employee's account balance increases, a terminating employee is less likely to cash out the account. As noted above, one study estimated that the average cash distribution at job change was \$32,219 in 2006.³⁰

2. Age of the Workers – Younger workers tend to have lower account balances relative to their older cohorts (due to fewer years participating in a qualified plan). In addition, younger workers are much more likely to cash out these smaller account balances. The 2011 Aon Hewitt retirement survey estimated that 53 percent of terminating employees who were younger than 30 years of age cashed out their retirement savings.

Graph 5 Percentage of Terminating Employees Who Cash Out Retirement Savings, by age, 2010

Source: Aon Hewitt Retirement Survey, 2011



Yet, research indicates that as an individual reaches 40 years of age or older, they tend to have financial challenges that make it more likely that they will use their retirement savings.³¹ This is particularly true when an older worker terminates employment. In many cases, they have more complicated financial demands (e.g., retaining a primary residence or college-aged children) and retirement savings may represent the only available form of savings. Numerous surveys of plan participants report similar findings.³² However, as participants age, they are more likely to retain their retirement assets, even following a job change.

3. Lower-Paid Workers – Workers with lower-wage employment also tend to be more likely to withdraw or cash-out retirement savings, particularly at job change. Research by

³⁰ Refer to Copeland, Craig, *Lump Sum Distributions at Job Change*, Employee Benefits Research Institute, Notes 30(1), January 2009.

³¹ Refer to Fellowes, Matt and Katy Willemin, *The Retirement Breach in Defined Contribution Plans Size, Causes, and Solutions*, HelloWallet, January 2013.

³² *Ibid.* Refer also to *Leakage of Participants' DC Assets: How Loans, Withdrawals, and Cashouts Are Eroding Retirement Income 2011*, AON Hewitt, 2011; and *How America Saves 2012*, The Vanguard Group, Inc., 2012.

Butrica, et al. indicates that workers in the lowest income quartile are much more likely (28.6 percent) to make withdrawals from retirement savings than those in the highest income quartile (16.4 percent).³³

4. Minority Workers – African-American and Hispanic workers have significantly higher cash-out rates than white workers (see Table 2).

Table 2 – Employee Actions Taken Upon Job Termination, Percentages by Racial and Ethnic Group			
Action	African-American	Hispanic	White
Leave Balances in Employer Plan	12%	15%	27%
Rollover to New Plan or IRA	25	28	34
Cash-Out With Penalty	63	57	39

Source: *401(k) Plans In Living Color. A Study of 401(k) Savings Disparities Across Racial and Ethnic Groups*, the Ariel/Aon Hewitt Study 2012.

These higher cash-out rates could occur partially because the average account balances for African-Americans and Hispanics are significantly smaller than the average account balances for whites with the same salary rate. However, even accounting for size of account balances, African-American and Hispanic workers tend to have higher cash-out rates.

E. DOL REGULATIONS MAY REDUCE ACCESS TO CALL CENTER AND BROKER-DEALER ASSISTANCE FOR TERMINATING EMPLOYEES

On October 22, 2010, DOL proposed regulations to modify the standards for fiduciary liability with respect to retirement savings plans. In 2011, the DOL announced that the regulations would be re-proposed.³⁴ The re-proposed regulation is generally expected to apply the revised fiduciary standard to assistance provided to terminating employees by call centers and broker dealers. In some cases, a terminating employee will contact a call center or broker-dealer associated with an employer’s retirement savings plan to understand his or her options with respect to the employee’s retirement savings account balance. In other cases, a call center or broker-dealer might reach out directly to a terminating employee to help the employee understand his or her options. If broker-dealers and call centers become fiduciaries under the DOL regulations as expected, such contacts with terminating employees would generally be prohibited under the prohibited transaction rules, even if the advice given is in the best interest of the employees, unless comprehensive exemptions are provided by the DOL. If the re-proposed regulations fail to provide such exemptions for this type of assistance, then employees will lose access to call center and broker-dealer assistance at this critical choke point in the retirement savings process.

³³ Refer to Butrica, Barbara A., Sheila R. Zedlewski, and Philip Issa. *Understanding Early Withdrawals from Retirement Accounts*. The Urban Institute, The Retirement Policy Program, Discussion Paper 10-02, May 2010.

³⁴ United States Department of Labor News Release, Release Number: 11-1382-NAT, September 19, 2011.

F. ACCESS TO CALL CENTER AND BROKER-DEALER ASSISTANCE REDUCES CASH-OUTS

A recent GAO report suggested that employees who change jobs often receive guidance and marketing from service providers' call centers encouraging them to roll their retirement savings into IRAs rather than keeping the savings in a 401(k) plan. However, very importantly, the GAO also noted that fears of fiduciary liability could inhibit communications with employees and the provision of information regarding distribution options. Inhibiting these communications creates a great risk to retirement savings – that terminating employees will take cash distributions instead of leaving their assets in their employer's plan or rolling over the assets to another plan or IRA. However, the GAO report ignores the fact that the greatest risk to retirement savings is that employees will take a cash distribution upon job termination. From a retirement security perspective, retaining the assets in either an employer plan or an IRA is preferable to cashing out.

The research on access to financial assistance typically examines assistance in the form of a paid financial advisor. However, individuals who seek assistance from a paid financial advisor tend to be those individuals who are higher income and have higher levels of financial literacy. Individuals with lower education and income, African-Americans, and Hispanics are significantly less likely to seek assistance from a paid financial advisor.

In a 2008 paper, Lusardi stated “individuals are most prone to decision-making in specific time periods. For example, the start of a new job pushes people to think about saving (often because they have to make decisions about their pensions), and it may be very important to exploit such *teachable moments*.”³⁵ Lusardi goes on to state that “to be effective, programs have to recognize the many differences among individuals, not only in terms of preferences and economic circumstances but also of their existing levels of information, financial sophistication, and ability to carry through with plans. In other words, relying on ‘one-size-fits-all’ principles can lead to rather ineffective programs.”³⁶

One of the key decision-making points for retirement savings is job termination, when an employee must decide what to do with their retirement savings with the employer. Employees frequently have access to a call center or a broker-dealer to help them understand their options at this decision-making point. In fact, most financial services firms make such assistance available to help employees make decisions concerning their retirement savings.

A recent study by the Government Accountability Office (“GAO”) indicated GAO’s strong preference for workers keeping their retirement savings in an employer plan, rather than moving the funds to an IRA.³⁷ However, this view does not address how to deal with many employees’ inclination not to leave their assets at their former employer’s plan, nor with some workers’ desires to obtain access to investments that may not be available under a former employer’s plan. Further, the GAO indicated that it had made calls to 401(k) and IRA service providers to request information about rollover options and IRAs, but it is unclear whether these calls went to sales lines or the company’s technical call centers. This clearly makes a significant difference in terms of the nature of the assistance. Most importantly, GAO’s report ignores the biggest risk to long-

³⁵ Lusardi, Annamaria. *Financial Literacy: An Essential Tool for Informed Consumer Choice?* January 2008.

³⁶ *Ibid.*

³⁷ Refer to the Government Accountability Office, *401(K) PLANS Labor and IRS Could Improve the Rollover Process for Participants*, GAO-13-30, March 2013.

term retirement security, which is the preretirement cash out of retirement savings. From a retirement security perspective, retaining the assets in either an employer plan or an IRA is preferable to cashing out.

None of the research to date has examined the effects of employee access to call center assistance on retirement savings. As a result, very little information is available concerning the effects of call center assistance on retirement savings outcomes. In order to help fill this gap in the research, we conducted interviews of several large financial services firms serving a broad range of individuals concerning their call center operations with respect to employer retirement savings plans. The information and data collected from these interviews help to construct a better picture of how access to call centers assists employees with important retirement savings decisions.

Millions of employees contact call centers associated with their retirement plan each year.³⁸ Some of the calls represent basic transactions, such as a balance inquiry or providing an address change. For some companies, the initial call will be handled by a basic service representative, who will handle the most basic inquiries and will transfer the caller to a licensed representative for any other question or request.

The financial services firms view their call center operations as an important way to help educate employees on the importance of preserving their retirement savings. In addition to responding to employees who contact a call center, some companies make proactive calls to employees at key decision points to make sure employees are educated concerning their options. Companies with whom we spoke as part of our research generally indicated that their general approach was to discourage terminating employees from cashing out their retirement savings. One company indicated that, with terminating employees, they would send a letter explaining the employee's options, followed by a telephone call, generally advising against cashing out. Another company indicated that the most impactful way to help plan participants was a proactive call to help with options when an employee terminates employment.

In addition, some employees have direct access to a broker-dealer for assistance. This might occur if an employee has set up an IRA using a broker-dealer or if an employer (often a small employer) has a broker-dealer who helped the employer establish a retirement plan for employees. In many cases, broker-dealers assist employees who could not otherwise afford to hire a financial advisor. While it is more difficult to quantify the extent to which employees might access a broker-dealer for assistance for help understanding their options with respect to their retirement savings, this access represents another important way in which employees receive assistance with respect to their retirement savings and, more generally, their financial literacy.

As a result, call center and broker-dealer assistance is an important source of information to employees. The evidence suggests that access to this assistance improves retirement savings outcomes. One financial services company reported that cash-out rates for individuals with account balances between \$35,000 and \$50,000 decline significantly when an employee receives a proactive call (3.3 percent cash-out rate) relative to those who only receive a written communication (10.5 percent cash-out rate). This compares to a cash-out rate for this company of 34 percent for all former employees each year.

³⁸ These call centers should be distinguished from the sales forces that may have been involved in the GAO study discussed above.

III. ESTIMATING THE EFFECTS OF REDUCING AVAILABILITY OF CALL CENTER OR BROKER-DEALER ASSISTANCE ON CASH-OUTS OF RETIREMENT SAVINGS

When an employee terminates employment, cashing out accumulated retirement savings may be appealing. Many employees lack the basic financial literacy needed to make an informed decision, which leads to a failure to understand the long-term consequences of these cash-outs. In particular, an employee with high debt levels or other financial pressures rarely appreciates the importance of keeping the assets in a qualified retirement savings vehicle. Similarly, an employee who has a relatively small retirement savings balance does not understand the long-term consequences of cashing out. Finally, the process of rolling over retirement savings into a plan of a new employer or an IRA presents complexities that many plan participants fail to understand. Having access to a call center or broker-dealer for assistance may help a terminating employee gain a clearer picture of all the options with respect to his or her retirement savings and the consequences of each option.

If the DOL re-proposed regulations extend fiduciary liability to call center and broker-dealer assistance without an exemption to permit the types of contacts that routinely occur when employees terminate employment, then cash outs at termination of employment will increase and long-term retirement security will decline. The following sections estimate the potential impacts of these changes, including estimates of (1) the aggregate potential reduction in retirement savings and (2) the effect of cashing out retirement savings on retirement savings accumulations over a 30-year work history. These potential impacts may affect disproportionately individuals in the most vulnerable populations.

A. INCREASED WITHDRAWALS FROM RETIREMENT SAVINGS

The estimates of increased cash-outs of retirement savings and reduced rollovers to IRAs and other qualified plans rely on a number of data sources as well as our estimates of the effect of call centers and/or broker-dealer assistance on these cash outs.

The first step in estimating the potential increases in cash-outs from retirement assets and reduced rollovers to IRAs and other qualified plans requires estimating pension participation by income class. This analysis relies on Internal Revenue Service (IRS) Statistics of Income (SOI) tabulations of the elective deferrals claimed on taxpayers' Form W-2 for 2010.³⁹ Table 3 displays the number of taxpayers with elective deferrals and the aggregate amount of the deferral.

The second step is to impute aggregate balances for the distribution of taxpayers reporting retirement contributions on Form W-2. This information relies on several surveys. Using multiple data sources provided an opportunity to verify and corroborate the assumptions applied to the taxpayer characteristics.⁴⁰

³⁹ The IRS tabulation of W-2 data includes elective deferrals from all employer-provided defined contribution amounts for primary and/or secondary taxpayers. Elective retirement contributions are reported on the Form W-2, box 12 and includes the following codes: code D (traditional 401k), code E (traditional 403b), code F (SEP), code G (457b), code H (501(c)(18)(D)), code S (SIMPLE), code AA (Roth 401k), and code BB (Roth 403b).

⁴⁰ Refer to Appendix A for a detailed description of the data sources and the methodology.

**Table 3 – Taxpayers with Elective Retirement Contributions, by
Size of Adjusted Gross Income, 2010**

(Dollar Amounts are in thousands)

Adjusted Gross Income	Returns	Contribution Amount
Under \$10,000	628,363	\$723,644
\$10,000 under \$20,000	1,840,733	1,205,130
\$20,000 under \$30,000	3,569,640	3,990,174
\$30,000 under \$40,000	4,116,205	6,896,514
\$40,000 under \$50,000	3,881,058	8,825,907
\$50,000 under \$75,000	8,927,933	28,557,724
\$75,000 under \$100,000	7,719,584	33,078,699
\$100,000 under \$200,000	11,607,079	79,943,732
\$200,000 or more	3,495,241	45,992,983
Total	45,785,836	209,214,507

Source: IRS, Statistics of Income tabulations of the elective deferrals claimed on taxpayers' 2010 Form W-2.

The third step is to estimate the qualified plan participants who may experience a break in service (through job termination) and face a decision regarding plan assets held with their previous employer. The Job Opening and Labor Turnover Survey (JOLTS) from the Bureau of Labor Statistics estimated that 37.1 percent of current workers experience separation from employment during the year. The definition of separation includes voluntarily quitting, being laid off, or being fired.⁴¹

From this information, we derive estimates of the potential retirement savings balances that are likely to become vulnerable to cash out.⁴² We assume that those employees cashing out balances currently will continue to do so. With respect to employees choosing to leave account balances in a former employer's plan passively (through inaction), we assume that the small number of account balances that would have remained passively with the former employer will also be likely to remain there.

Our analysis assumes that the balances most vulnerable to increased cash-out are those currently being rolled into IRAs or a new employer plan and those that currently remain in an employer's plan through an employee decision. These amounts reflect those decisions that are most likely to be assisted by a call center or broker-dealer. Our estimates indicate that, each year, these balances total approximately \$117 to \$145 billion.

Our final step involves investigating the role of call center and broker-dealer assistance in helping workers retain their retirement savings at job change. Our research relies on a DOL-sponsored pilot survey that looks at how current enrollees in employer-sponsored defined contribution (DC) plans make retirement decisions.⁴³ Our empirical models suggest that

⁴¹ Refer to Hathaway, Kendra C., *Job openings continue to grow in 2012, hires and separations less somewhat*, JOLTS Annual Story, Monthly Labor Review, May 2013.

⁴² In addition, the estimates include an adjustment for the likelihood that workers separating from employment have access to a qualified plan.

⁴³ The survey asked the following question: "How do you make decisions about savings and investment related to retirement?" The possible responses were: "1 Ask relatives/friends, 2 Talk to financial planners/brokers, 3 Talk to lawyers, 4 Read magazines/newspapers/books, 5 Get advice from television, and 6 Other." Of the respondents who had not already retired, approximately 24 percent indicated that they had talked to financial planners/brokers. These contacts likely include both consultation with a paid financial planner and contacts through a call center or broker-dealer associated with their employer's retirement savings plan.

retirement savings plan balances are 33 percent higher if a financial planner or broker was consulted for financial advice. Our parameter estimates support our theory that consultations with call centers or brokers/dealers result in retirement savings in DC plans that are higher by about 33 percent. Our model suggests important life-cycle effects are present in retirement savings with plan balances increasing with age initially and then increasing at a decreasing rate as workers approach retirement age.

Based on the estimated cash-outs from retirement balances for terminating employees, we estimate that reducing the availability of call center and broker-dealer assistance will increase annual cash outs of retirement savings at job termination by an additional \$20 – 32 billion.⁴⁴

B. LONG-RUN EFFECTS ON RETIREMENT SECURITY

Cash outs of retirement savings prior to retirement not only reduce retirement savings by the amount withdrawn, but also by the earnings that those amounts would accrue if they were not withdrawn.⁴⁵

The following example shows the effects of withdrawals of retirement savings early in a working career, which corresponds to the work history of many workers who may change jobs three or four times during the early years of their working career. The first stream of retirement savings represents the accumulation of assets assuming no cash out prior to retirement age (i.e., the assets either remain in an employer's plan or the individual rolls over to an IRA or a new employer's plan). This individual, who earns \$40,000 in 2014 (assuming 2.5 percent annual increases in salary and a 5 percent deferral rate), will accumulate \$124,742 during her career (assuming 4 percent annual earnings on those contributions).⁴⁶

Assume the same individual changes jobs three or four times during the early years of employment and cashes out her retirement savings at each job change with the final cash-out occurring after year six. This behavior means the individual is essentially beginning to save for retirement in the seventh year of employment. Withdrawing the retirement balances in the early years of employment (with consistent savings thereafter) will reduce the individual's accumulated retirement savings by \$32,093.

⁴⁴ Refer to Appendix A for a detailed description of our empirical work.

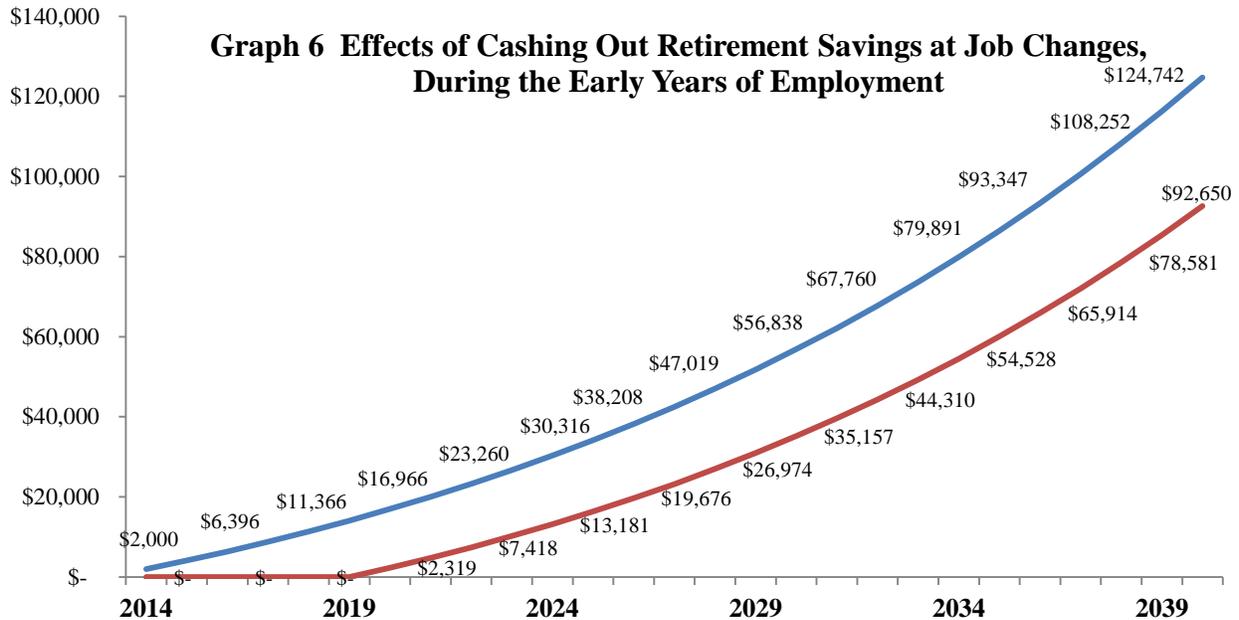
⁴⁵ In addition, the amounts withdrawn frequently are subject to Federal and state income taxes plus penalty taxes on early withdrawals.

⁴⁶ This deferral rate is consistent with average deferrals based on Internal Revenue Service Statistics of Income data tabulations of the Form W-2 for taxpayers with \$40,000 of wage income.

Table 4 – Effects of Cashing Out Retirement Savings, with Job Changes Early in the Work History					
Year	Account Balance		Year	Account Balance	
	No Distributions	Distribution at Job Changes		No Distribution	Distribution at Job Change
2014	\$ 2,000	\$ -	2028	\$ 47,019	\$ 26,974
2015	\$ 4,130	\$ -	2029	\$ 51,797	\$ 30,950
2016	\$ 6,396	\$ -	2030	\$ 56,838	\$ 35,157
2017	\$ 8,806	\$ -	2031	\$ 62,154	\$ 39,606
2018	\$ 11,366	\$ -	2032	\$ 67,760	\$ 44,310
2019	\$ 14,083	\$ -	2033	\$ 73,668	\$ 49,280
2020	\$ 16,966	\$ 2,319	2034	\$ 79,891	\$ 54,528
2021	\$ 20,022	\$ 4,790	2035	\$ 86,446	\$ 60,068
2022	\$ 23,260	\$ 7,418	2036	\$ 93,347	\$ 65,914
2023	\$ 26,688	\$ 10,212	2037	\$ 100,610	\$ 72,080
2024	\$ 30,316	\$ 13,181	2038	\$ 108,252	\$ 78,581
2025	\$ 34,152	\$ 16,332	2039	\$ 116,290	\$ 85,432
2026	\$ 38,208	\$ 19,676	2040	\$ 124,742	\$ 92,650
2027	\$ 42,494	\$ 23,220			

Both examples assume the individual has a starting salary of \$40,000, receives 2.5 percent annual increases, defers 5 percent of salary each year, and earns 4 percent interest on those contributions.

Graph 6 displays the effect of this behavior on the accumulated earnings. This reduces the ultimate retirement savings balance by approximately 26 percent.



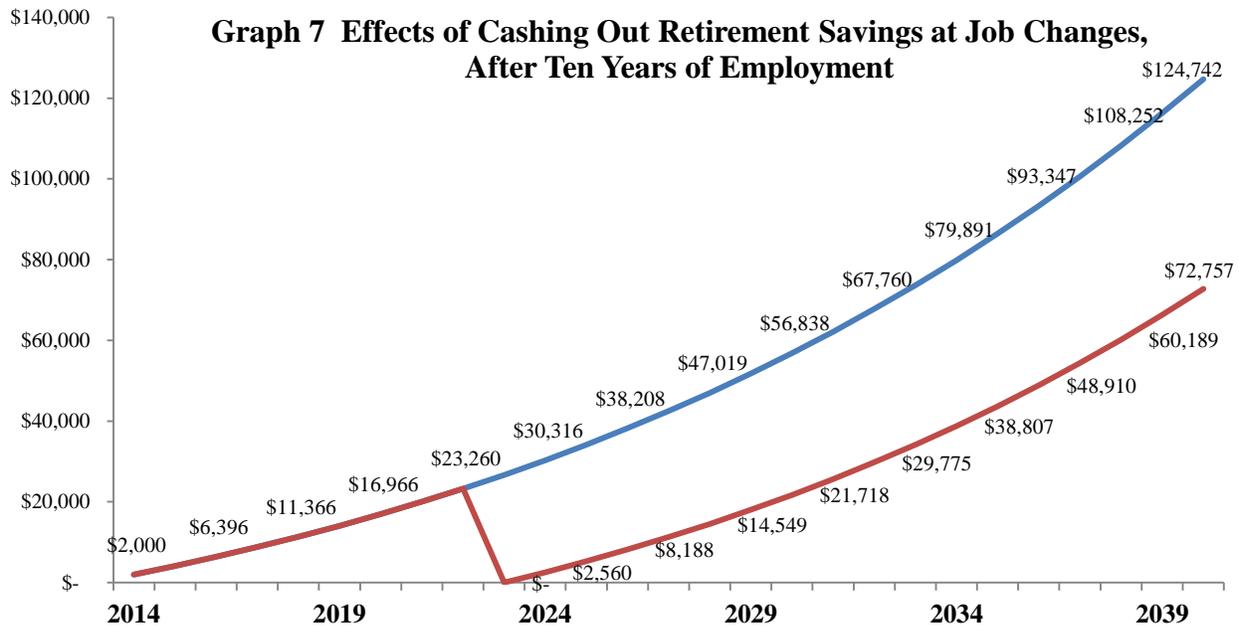
While it is common for younger workers to cash out balances, the average account distribution is considerably higher (\$32,219) suggesting that cash outs also occur later in a working career. Using the same example, this is comparable to a worker cashing out his or her retirement savings when changing jobs after 10 years. The effect of this behavior is to reduce the individual's total retirement savings by nearly \$52,000 or 41 percent.

Table 5 – Effects of Cashing Out Retirement Savings, with Job Changes After 10 Years

Year	Account Balance		Year	Account Balance	
	No Distributions	Distributions at Job Changes		No Distribution	Distribution at Job Change
2014	\$ 2,000	\$ -	2028	\$ 47,019	\$ 14,549
2015	\$ 4,130	\$ -	2029	\$ 51,797	\$ 18,028
2016	\$ 6,396	\$ -	2030	\$ 56,838	\$ 21,718
2017	\$ 8,806	\$ -	2031	\$ 62,154	\$ 25,630
2018	\$ 11,366	\$ -	2032	\$ 67,760	\$ 29,775
2019	\$ 14,083	\$ -	2033	\$ 73,668	\$ 34,163
2020	\$ 16,966	\$ -	2034	\$ 79,891	\$ 38,807
2021	\$ 20,022	\$ -	2035	\$ 86,446	\$ 43,718
2022	\$ 23,260	\$ -	2036	\$ 93,347	\$ 48,910
2023	\$ 26,688	\$ -	2037	\$ 100,610	\$ 54,396
2024	\$ 30,316	\$ 2,560	2038	\$ 108,252	\$ 60,189
2025	\$ 34,152	\$ 5,287	2039	\$ 116,290	\$ 66,304
2026	\$ 38,208	\$ 8,188	2040	\$ 124,742	\$ 72,757
2027	\$ 42,494	\$ 11,273			

Both examples assume the individual has a starting salary of \$40,000, receives 2.5 percent annual increases, defers 5 percent of salary each year, and earns 4 percent interest on those contributions.

Graph 7 displays the cumulative effects of cashing out after ten years of employment over the remaining working career.



These two examples rely on conservative assumptions and present the effects on a worker earning the U.S. median salary. The effects would increase significantly with modest changes in the assumptions. For instance, as the interest rate increases, the accumulation gap between not cashing out and cashing out grows much wider. In addition, if the individual were to defer the maximum amount each year or if the employer provided matching contributions, the effects would also multiply. In each of these cases, the gap widens and the effects on retirement security become more significant.

C. AFFECTING THE MOST VULNERABLE POPULATIONS

Individuals who hire a financial advisor tend to be higher income and have more general education than other individuals. That is not the case for individuals who contact a call center or broker-dealer associated with their employer's retirement plan. Information that we received from financial services firms suggests that a wide range of individuals utilize this type of service to help them with their retirement savings decisions. For example, one company's call center data for the first quarter of 2013 indicated that nearly 80 percent of the calls related to individuals with no more than \$50,000 of assets in their retirement savings plan and nearly 50 percent of the calls related to individuals with no more than \$5,000 in the plan. Nearly 60 percent of the calls related to individuals under age 50 and more than 60 percent related to individuals with less than 10 years of service with the employer.

One of the greatest risks to long-term retirement savings is the potential for pre-retirement cash outs of retirement savings. Cash-outs are highest among individuals who are younger, have lower wages, and have less tenure with an employer. Higher cash-out rates are also an issue for African-Americans and Hispanics. Assistance provided by call centers and broker-dealers at job termination plays a key role in trying to reduce cash-out rates, particularly among these groups who are least likely to use the services of a paid financial planner. One financial services company indicated that oral communications with employees terminating employment has a significant effect on cash-out rates; employees with account balances between \$35,000 and \$50,000 are approximately 3.2 times less likely to cash out their retirement savings if they receive a call rather than only receiving written communications. As a result, reducing access to call center and broker-dealer assistance will likely disproportionately affect the individuals who are most vulnerable to cash outs.

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APPENDIX A – TECHNICAL EXPLANATION OF STUDY ESTIMATES

The estimates of increased cash-outs from qualified retirement savings rely on a number of data sources as well as our estimates of the effects of reducing employee access to assistance through call centers and broker-dealers. The estimates attempt to characterize and quantify the potential asset erosion from retirement savings when participants are unable to obtain assistance at job change, when they must make decisions regarding their retirement plan assets.

We first estimate pension participation and IRA contributions by income class. Because cashouts of retirement savings at job change tend to correlate negatively with income (i.e., individuals with higher income are less likely to cash out their retirement savings at job change), we can use the income distribution of pension and IRA participation to help us capture these effects. The Internal Revenue Service Statistics of Income (SOI) data provide the starting point for this step. The SOI presents tabular data based on information collected from matched samples of Form 1040, U.S. Individual Income Tax Return; and Form W-2, Wage and Tax Statement, for Tax Years.

Data from individual income tax returns rely on a stratified probability sample.⁴⁷ Information on wages and retirement contributions rely on Forms W-2 matched to the sampled individual income tax return. The individual income tax return provides information on the gender and age of a taxpayer (obtained by matching the primary and secondary Social Security numbers on the individual income tax return to information from the Social Security Administration). Form W-2, box 12 provides detail on the type of retirement plan. The SOI collects this information on an individual taxpayer basis. These estimates retain information on age, gender, filing status, and wage and salary income levels to reflect certain characteristics that are likely to affect account balances.

We impute aggregate balances for the distribution of taxpayers reporting retirement contributions on Form W-2 relying on data from two surveys, which provides an opportunity to verify and corroborate the assumptions applied to the taxpayer characteristics. The first survey is the Survey of Consumer Finances (SCF), a survey of U.S. households sponsored by the Board of Governors of the Federal Reserve System with the cooperation of the U.S. Department of the Treasury every three years. The second survey is the Employee Benefits Research Institute and the Investment Company Institute (EBRI/ICI) survey of retirement plans. The EBRI/ICI survey collects information about individual 401(k) plan participant accounts. As of December 2010, the database included information about 23.4 million 401(k) plan participants in 64,455 employer-sponsored 401(k) plans, representing \$1.414 trillion in assets. In addition, the EBRI/ICI survey collects data from plan recordkeepers and, therefore, is able to capture the characteristics of the plan activity. The survey retains information on demographic, contribution, asset allocation, and loan and withdrawal activity information for millions of participants, which enables estimates of the cumulative changes in account balances. Together, these surveys provide qualitative information that allows imputation of account balances.

From this base, we estimate those qualified plan participants who experience a break in service (through job termination) and face a decision regarding plan assets held with their previous employer. The Job Opening and Labor Turnover Survey (JOLTS) from the Bureau of Labor Statistics provides current statistics on labor turnover by selected worker characteristics. The

⁴⁷ Refer to Statistics of Income—2010, Individual Income Tax Returns documentation for the description of the sampling procedures and data limitations of Statistics of Income tabulations.

JOLTS measures hires and separations on a monthly basis. Historical estimates that correspond with the reference year data (2010) support these estimates.

Finally, we investigate the role of financial planners and brokers in helping workers save for retirement. Our research (described in detail below) relies on a DOL-sponsored pilot survey conducted through the Rand American Life Panel that looks at how current enrollees in employer-sponsored defined contribution (DC) plans make retirement decisions.

Rand American Life Panel (ALP)

Since 2006, the Rand Corporation has fielded a survey of approximately 6,000 individuals who have agreed to participate in occasional, on-line surveys on topics of interest to policymakers. Approximately 350 surveys have been conducted to date on topics as diverse as financial decision-making, financial literacy, self-reported health and well-being and Social Security knowledge. Participants in the ALP are selected from several other, on-going surveys in the United States including the University of Michigan Monthly Survey, the National Survey Project cohort and active recruitment based on the nature of the survey.

Well-Being Survey 189 is a DOL-sponsored pilot survey to ascertain the retirement plans of individuals. The survey was conducted between June and August of 2011 and resulted in 3,061 completed interviews with a response rate of slightly over 85 percent. In addition to a basic core module that provides demographic information on the respondents, the survey also includes modules on:

- Retirement Planning;
- Income and Transfers;
- Assets and Liabilities;
- Retirement Savings Behavior;
- Employer Retirement Savings Plans and Design;
- Financial Literacy; and
- Risk and Time Preferences.

For the purposes of this research, we focus primarily on the demographic characteristics of workers enrolled in employer-sponsored DC plans, plan balances, the investment decisions of the plan participants, indicators of financial literacy, and the decision to rely on a financial planner or broker to assist in retirement decisions.

The Model

For this preliminary research, we constructed an econometric model of plan balances for workers in the Well Being 189 Survey who indicated they were enrolled in a company-sponsored DC plan. We investigate how access to a financial planner might affect retirement savings outcomes. For this purpose, we define plan balances as the sum of (1) current plan balances; (2) balances in plans from prior employers; and (3) any IRA or Keogh plan balances that the respondent may have. Of the 3,061 survey respondents, 837 met our criteria.

We also construct several variables from the Survey that we believe should be strong predictors of retirement savings:

AGE:	The age of the respondent.
AGESQR:	The age of the respondent squared (to capture life-cycle effects).
INCOME:	Total income of the respondent.
CHRONIC:	An indicator if the respondent reported suffering from a chronic disease such as cancer, diabetes or stroke.
TENURE:	An indicator if the respondent owned a home.
FRACTION_STOCK:	The fraction of current plan balance that is invested in stocks.
LITERACY:	An index of financial literacy.
PLANNER:	An indicator if the respondent said he/she relied on a financial planner or broker for assistance.

We expect total plan balances to be positively related to income capturing the fact that a higher income should result in more resources devoted to retirement savings. In contrast, we expect retirement savings to be negatively related to health status (as captured in the CHRONIC variable) as this could mean time spent out of the labor force, reduced hours of work, or other impediments to lifetime earnings. Similarly, we expect retirement savings to be positively related to owning a home (TENURE), suggesting that homeowners may have more resources that can be devoted to saving for retirement.

Appendix A - Table 1. Description of Variables Used in the Model ^{1/}

Name	Description
LNBALANCE	Natural logarithm of total plan balances in 2010. Includes balances of existing plan, plans from prior employment and any IRA or Keogh plans.
AGE	Age of survey respondent.
AGESQR	Age of survey respondent squared.
LNINCOME	Natural logarithm of total income.
CHRONIC	Takes a value of 1.0 if the respondent reports suffering from a chronic illness (e.g., cancer, diabetes) and zero otherwise.
TENURE	Takes a value of 1.0 if the respondent is a homeowner.
FRACTION_STOCKS	The fraction of current plan assets invested in stock.
LITERACY	Index of financial literacy equal to the number of correct responses to survey questions relating to numeracy, inflation and risk diversification.
PLANNER	Takes a value of 1.0 if the respondent indicates he/she has consulted with a financial planner or broken in planning for retirement.

^{1/} Variables are calculated from survey questions contained in the American Life Panel, *Well Being Survey 189, DOL Pilot*.

We have no a priori expectation about how the fraction of stock in one's portfolio might affect plan balances. Because stocks generally have higher long-term growth than bonds, we would expect this variable to be positively related to plan balances. On the other hand, because the survey was conducted in mid-2011, those plans with a large stock component could have

suffered from the recent financial crisis. We expect financial literacy to be positively correlated with plan balances to the extent enrollees make better financial decisions relating to their retirement savings. Finally, we expect that plan balances should be positively related to seeking planning advice from a professional advisor.

In order to control for the wide variation and degree of skew in plan balances, we use the natural logarithm of total plan balances as our dependent variable. We also use the natural logarithm of total income as a predictor variable. Appendix Table 1 describes the variables used in our analysis and Appendix Table 2 reports summary statistics for each.

Appendix A - Table 2. Mean and Standard Deviation of Variables Used in the Model ^{1/}

Variable	Mean (N=837)	St. Dev. (N=837)
LNBALANCE	9.9285	2.7615
AGE	47.0824	11.3594
AGESQR	2,345.6400	1,073.7000
LNINCOME	10.8762	1.8997
CHRONIC	0.3154	0.4650
TENURE	0.7790	0.4152
FRACTION_STOCKS	0.7384	0.4398
LITERACY	2.3214	0.9638
PLANNER	0.5317	0.4993

^{1/} Variables are calculated from survey questions contained in the American Life Panel, *Well Being Survey 189, DOL Pilot*.

The statistics show that, of our sample of 837 enrolled workers, the average age is 47 years, approximately 32 percent have experienced some type of chronic health problem, 78 percent are homeowners, about 74 percent of current plan balances are in stocks, and slightly more than half consulted with a financial planner.

Results

Our results are shown in Appendix Table 3. The estimated coefficients conform to our expectations about how certain variables relate to plan balances. The positive coefficient on AGE shows that, at least for our sample, plan balances at first rise with age, as one would expect. In contrast, the negative coefficient on AGESQR indicates that balances begin to increase at a slower rate at some point in the life-cycle, perhaps due to withdrawals or a movement towards safer, fixed-income investments as one gets older.

Appendix A - Table 3. Estimation Results for Total Plan Balances in 2010 ^{1/}
(Standard Errors in Parentheses)

Variable	<u>Dependent Variable</u> LNBALANCE
AGE	0.18585** (0.0406)
AGESQR	-0.0014** (0.0004)
LNINCOME	0.36822** (0.0445)
CHRONIC	-0.1334 (0.1857)
TENURE	0.78026** (0.2058)
FRACTION_STOCKS	1.10525** (0.1999)
LITERACY	0.31658** (0.0939)
PLANNER	0.33368** (0.1666)
Number of Observations	837
Adjusted R-Square	0.2793
F-Value	41.49**

^{1/} Coefficient estimates from unweighted, ordinary least squares on employed respondents enrolled in a employer-provided defined contribution plan in 2010.

* Statistically significant at 90 percent confidence levels.

** Statistically significant at 95 percent confidence levels.

Plan balances correlate positively with income and homeownership as indicated by the positive coefficients on these two variables and correlate negatively with health status. Both these results are expected. The fraction of plan balances held in stocks (FRACTION_STOCKS) suggests a strong, positive effect on plan balances. As expected, larger plan balances are positively related to financial literacy and the use of a financial planner. Because of the log specification of our model for plan balances, we can interpret the coefficient on PLANNER as indicating that plan balances are about 33 percent higher if an individual consulted a financial planner or broker for financial advice.

All the coefficients in our model, except CHRONIC, are statistically significant at 95 percent confidence intervals. The adjusted R-square of 0.28 is reasonably high for cross section data.

Conclusions and Suggestions for Future Research

Our model of DC plan balances performs quite well. Our parameter estimates supports our theory of how certain variables might influence retirement savings. In particular, having access to a financial planner or broker appears to result in retirement savings in DC plans that are higher by about 33 percent. Our model suggests important life-cycle effects are present in retirement savings with plan balances increasing with age initially and then at decreasing rate as workers approach retirement age.

May 14, 2014



THE IMPACT OF THE UPCOMING RE-PROPOSED DEPARTMENT OF LABOR FIDUCIARY REGULATION ON SMALL BUSINESS RETIREMENT PLAN COVERAGE AND BENEFITS

Greenwald & Associates

Co-Sponsored by the United States Hispanic Chamber of Commerce

Davis & Harman LLP commissioned and co-sponsored this report on behalf of a coalition of financial services organizations that provide retirement services to millions of Americans.

Foreword

Javier Palomarez
President & CEO, USHCC

The sustainability of American small business is inherently tied to the prosperity of our nation's workers and their ability to plan for tomorrow. Because small business owners create nearly two-thirds of net new jobs in the U.S., it is imperative to keep their interests top of mind.

As you might imagine, Hispanic entrepreneurs are an increasingly vital segment of the small business demographic. This thriving community numbers more than 3.1 million Hispanic-owned businesses, which will together contribute in excess of \$468 billion to the American economy this year.

The United States Hispanic Chamber of Commerce (USHCC), the country's largest Hispanic business organization, advocates on behalf of these enterprises through our network of more than 200 chambers and business associations, as well as over 220 major corporate partners nationwide.

At the USHCC, while we are proud to advocate on behalf of business owners who happen to be of Hispanic descent, we never forget that we are first and foremost American businesses. Every tax bill we pay, every job we create, every product we manufacture, and every service we provide goes to benefit our nation's economy.

Our association, as well as many financial services organizations and business owners, has strong concerns over the possible effects of the U.S. Department of Labor's (DOL) expected regulatory expansion of fiduciary status. This is why the USHCC has proudly partnered with Greenwald & Associates, one of the nation's leading full-service market research firms, to launch this survey. By polling over 600 retirement plan decision-makers at firms classified as small businesses, this study examines the rule's prohibitive nature on investment education and information that can be provided about retirement-plan accounts.

The findings presented here show that far-reaching regulatory changes, like a DOL expansion of fiduciary status, will only impede the ability of small firms to offer their employees retirement-plan accounts, thus hindering American workers from saving for a reliable future.

This report serves as a reputable source of information for policy makers, business leaders, and researchers who seek a thorough examination of DOL's expected regulatory expansion and how small business owners and their employees will be negatively impacted.

EXECUTIVE SUMMARY

Overview

The purpose of this research is to better understand the impact that a re-proposed Department of Labor regulation on the fiduciary status of persons providing investment assistance could have on small business qualified plans, particularly the impact on employees. The re-proposed regulation is generally expected to prohibit retirement plan providers and the advisors who sell retirement plans from assisting employers in the selection and monitoring of funds in the retirement plan. Instead, employers could either perform the functions themselves or hire an independent expert to do it. Please see Appendix 1 for a fuller description of the contemplated content of the re-proposed regulation, as provided to survey respondents.

The findings, as summarized in more detail in the “Summary of Findings” section of this report, were striking.

- **Almost 30% of small businesses with a plan indicate that it is at least somewhat likely that they would drop their plan if this regulation were to go into effect.**
- **Almost 50% of small businesses with a plan say that it is at least somewhat likely that the regulation would result in them reducing their matching contribution, offering fewer investment options, and increasing fees charged to participants.**
- **Close to 50% of small businesses without a plan state that the regulation would reduce the likelihood of them offering a plan, with 36% saying it would reduce the likelihood greatly.**
- **Over 40% of small businesses without a plan say that the regulation would be at least somewhat likely to cause them to charge higher fees to participants and not offer matching contributions.**
- **Over 80% rate the job that their current advisor or record-keeper does as very good or excellent when it comes to investment selection and over 90% are at least somewhat satisfied with the plan's investment options.**

Scope of Study

This study examines three broad topic areas:

- The current environment when it comes to investment selection and monitoring – how it is done today in smaller companies and how good a job small business plan decision-makers feel that their advisors, their record-keepers, and they do in performing these functions. The purpose of these questions is to determine, from the perspective of the company, how well the system is functioning. This will provide a baseline understanding of the need for additional regulation and provide insights as to what impact such regulation might have.
- How those small companies offering plans feel about the upcoming re-proposed regulation and what impact they believe the regulation would have on the likelihood that they will continue offering plans. In addition, this research also explores how those offering plans might change plan provisions and features if the regulation were to be adopted.

- How those not offering plans, but considering doing so, feel about the upcoming re-proposed regulation and what impact they believe the regulation would have on the likelihood that they will offer plans. In addition, the research examines how they might change the provisions of the plan they are considering if the regulation were to be adopted.

Thus, this research addresses the potential impact of the proposed regulation, in the eyes of employers responsible for offering plans, from several different perspectives.

Methodology

A total of 607 plan decision-makers were administered a 12-minute telephone survey using a sample from Dun and Bradstreet¹ – 505 with defined contribution plans and 102 without. To qualify for the survey, the respondent needed to be either the sole decision-maker or part of a small group of decision-makers regarding the company's retirement plan (or regarding whether or not to offer one) in a company that has been in business for at least two years with over \$400,000 in gross revenue.

Companies were split into four size categories based on the number of employees working for the firm – 10 to 49, 50 to 99, 100 to 249, and 250 to 500. Data was weighted to reflect the number of employees nationwide working in each of these size bands.

The study was conducted from November 18th to January 10th by National Research in Washington, DC.

SUMMARY OF FINDINGS

Current Environment

When examining how investment functions are performed in the smaller plan market and how companies evaluate this performance, several key findings suggest that advisors and record-keepers affiliated with plan providers play an important role.

- Roughly 67% rely on an advisor or record-keeper affiliated with a plan provider to provide support in investment selection and monitoring – most rely on the advisor. This is especially the case for smaller companies (employee size 10-49).
- When used, these parties predominately play a primary or collaborative role in investment selection.

But more importantly, a large majority of those responsible for their company's retirement plans give high grades to those helping with investment selection and monitoring, higher grades than they would give themselves:

- A large majority are very satisfied with their plan's current investment choices.
- A large majority say that the advisor or record-keeper does a very good or excellent job in helping in both the selection and monitoring of investments.

¹ Dun and Bradstreet (D&B) maintains a database of over 20 million U.S. businesses. Sources from which D&B compiles the data include, but are not limited to: yellow page telephone directories, credit reports, public records, government registries, financial data, trade directories, web sources and directories, and proprietary files. The compilation is reflective of the population of U.S. businesses by employee size.

- In contrast, around 50% of those surveyed say that they either do or would do a fair or poor job in selecting and monitoring investments themselves.

When asked about the mix of "affiliated" and "unaffiliated" funds they use, on balance respondents report a somewhat greater use of unaffiliated funds.

These findings suggest that employers are generally satisfied with the current system. Furthermore, if the regulation causes companies to try to do more of the investment selection and monitoring themselves, this could be problematic.

Reaction to Proposed New Regulation

When asked a series of questions about the upcoming re-proposed new regulation, those offering plans not only dislike the concept, but also feel that it will impact them to cut back on what they would offer employees:

- Sixty-five percent think the regulation is a bad idea.
- Almost 30% feel it is at least somewhat likely they would drop their plan if this regulation were to go into effect.
- About 80% would likely hire a third party for guidance and over 70% have some concern about whether or not the firm would do a good job.
- A small minority would try to do it themselves, with 51% of these being concerned about how good a job they would do.
- Close to 50% say that it is at least somewhat likely that they would cut back on their match, cut back on investment options, and increase the fees they would charge participants if the regulation were to be passed. Thirty-four percent say it is at least somewhat likely they would spend less money on educating employees and spend less on other benefits.
- Results suggest that the impact of the regulation would be most profound on smaller companies (employee size 10-49).

Those currently not offering a plan but considering offering one say that the upcoming re-proposed regulation would have a negative impact on the likelihood of their offering a plan and on the generosity of the plan they might offer:

- Close to 50% say that the regulation would reduce the likelihood of their offering a plan to some extent – 36% say it would reduce it greatly.
- Close to 50% say that it would be difficult to find an advisor they trust and over 50% say that having to find a third party expert to guide them on investment selection and monitoring would be a major obstacle to the likelihood of their offering a plan.
- Over 40% say that the cost of a third party advisor would be a major obstacle in offering a plan.
- Many say that the regulation would cause them to lower their sights when it came to the type of plan they would offer. A majority say that it would be at least somewhat likely they would offer fewer investment options, raise eligibility waiting times, and reduce employee education efforts. Over 40% say they would likely charge higher fees and not offer a match.

Thus, findings here suggest that the new regulation could have a negative impact on the number of employees who get offered plans and a profound negative impact on the quality and generosity of those plans.

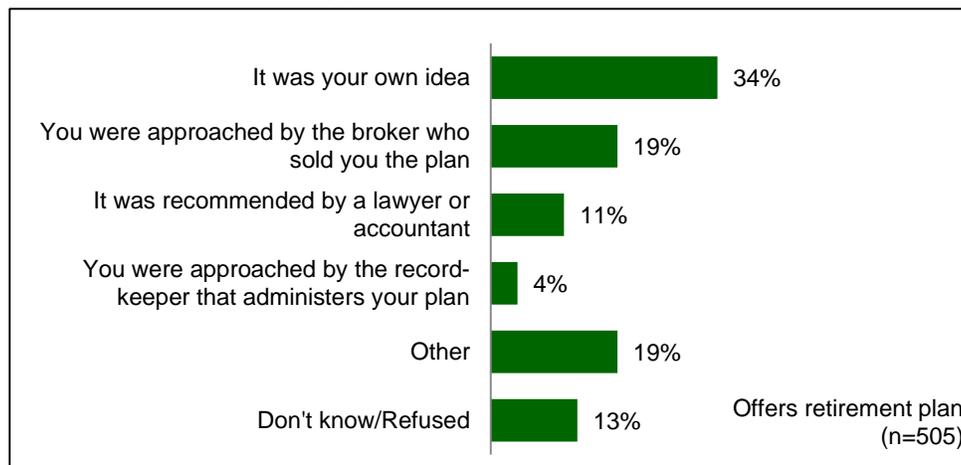
FINDINGS

Those Offering Plans

About the Current Plan

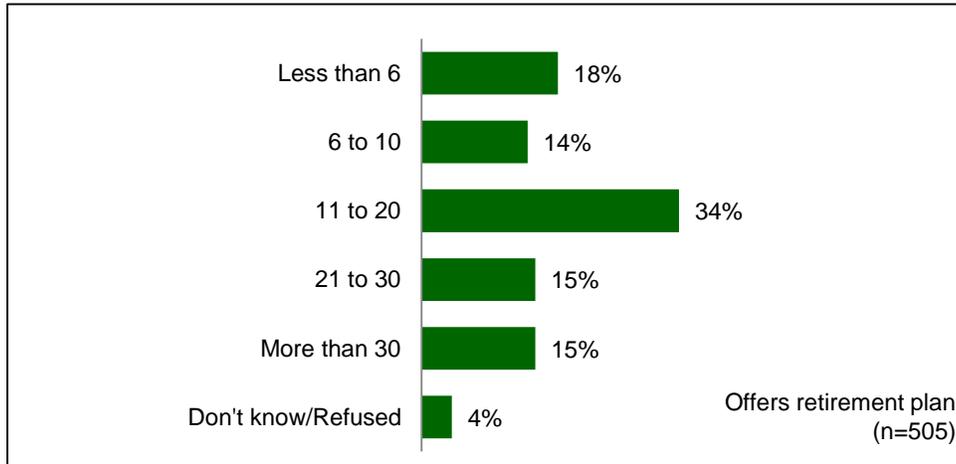
When asked how they came to adopt their current plan, respondents are evenly split between those who report that it was their own idea to do so and those who did so based on the recommendation of someone else, most often the broker selling them the plan.

Figure 1. Which of the following best describes how your company came to consider adopting your retirement plan?



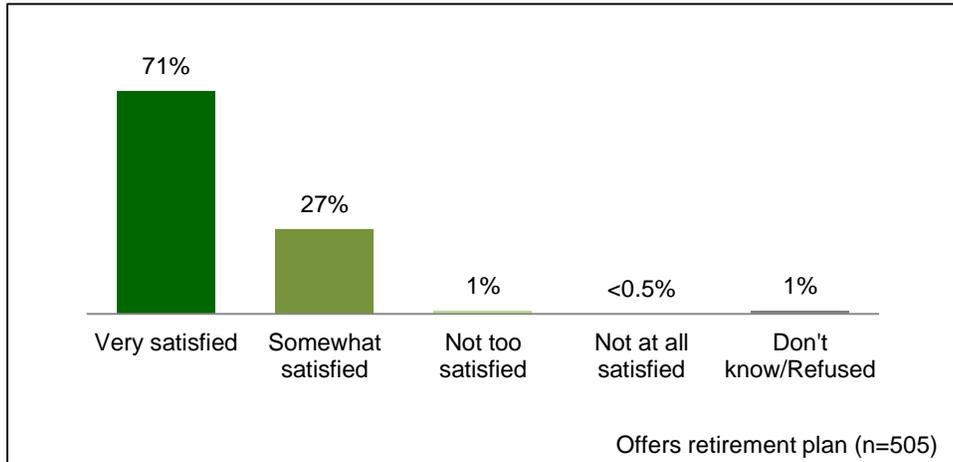
Thirty-two percent report offering ten or fewer options in their plan and 64% report offering more than ten options. The smallest companies (employee size 10-49) are most likely to offer the fewest options with 44% offering ten or fewer.

Figure 2. How many investment options do you offer for your retirement plan?



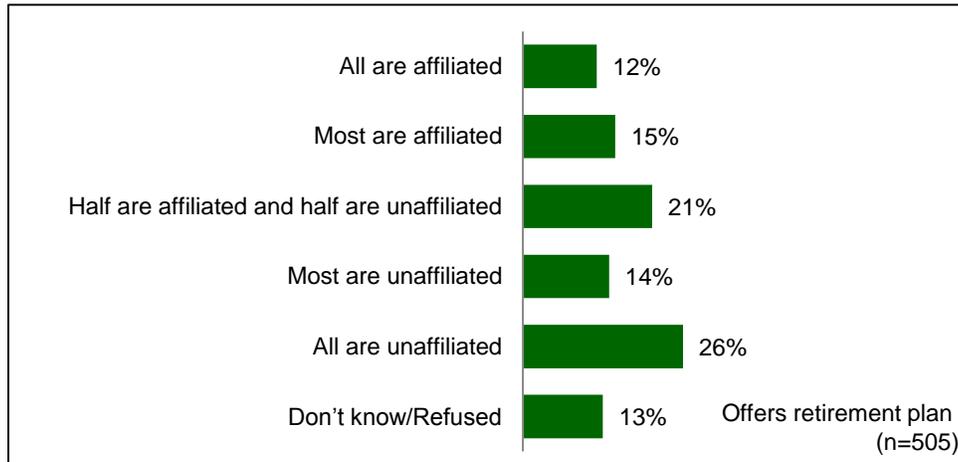
Company plan decision-makers strongly like the investment options in their plans. When asked how satisfied they are with their current investment options, 71% report that they are very satisfied and almost all the rest say they are somewhat satisfied.

Figure 3. How satisfied are you with your plan's current investment choices?



Company plan decision-makers were asked to describe the composition of their investments in terms of the proportion of funds that are "affiliated" with the provider (manufactured by the provider) or "unaffiliated" (manufactured by someone else). On balance, more funds are "unaffiliated." A little over 25% say that all (12%) or most (15%) of their fund are "affiliated." In contrast, 40% say that most (14%) or all (26%) of their funds are "unaffiliated." Twenty-one percent say their fund mix is half and half. Smaller companies (employee size 10-49) are slightly more likely to have all "affiliated" funds – 19% do so.

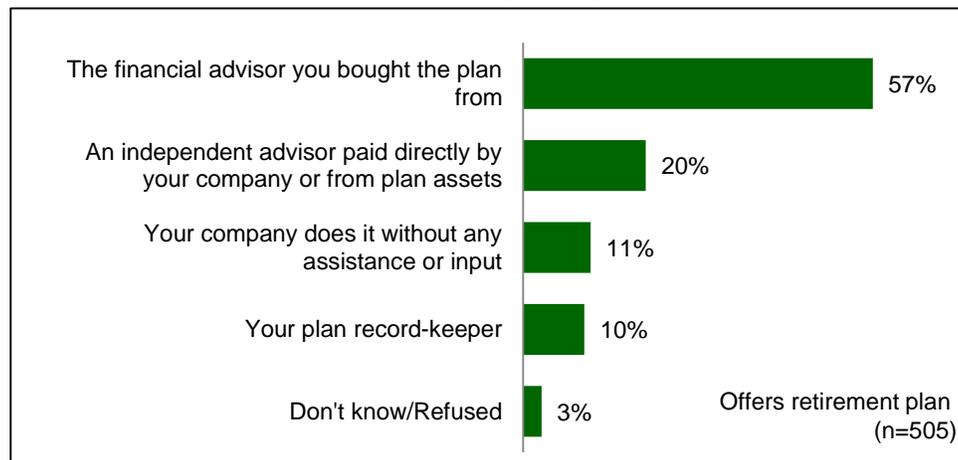
Figure 4. Thinking about the funds you offer your employees, what proportion fall into these categories (affiliated and unaffiliated)?



Role of Advisor and Record-keeper

Advisors play a major role in supporting the company's investment functions. When asked who they most closely work with to decide what investment options to offer, 57% say it is the advisor who sold them the plan, and another 10% say that it is the plan record-keeper. Only 20% hire an independent advisor, and 11% make investment selections themselves without any support. Smaller companies (employee size 10-49) are less likely to use an independent advisor, with only 11% doing so. Larger companies (employee size 250-500) are less likely to use the plan provider advisor, with only 40% doing so.

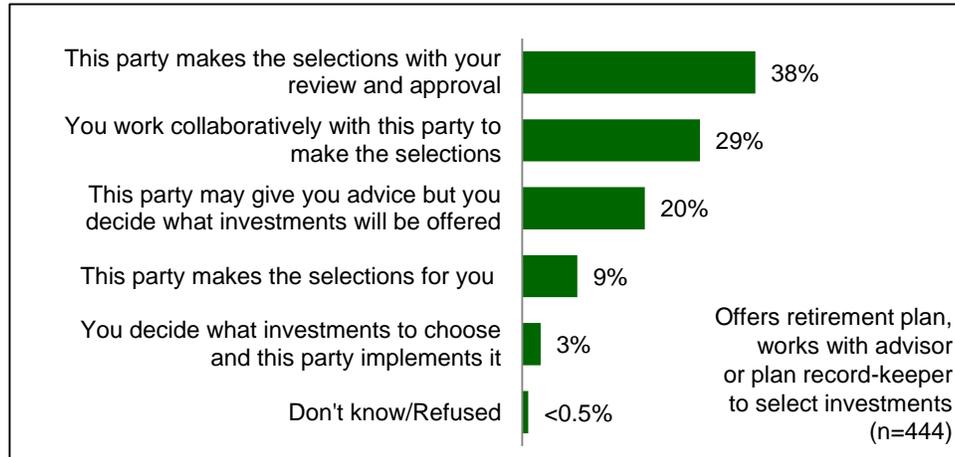
Figure 5. Who do you work with most closely to decide what investment options to make available to your employees in your retirement plan?



The plan provider advisor or record-keeper plays an important role in the investment selection process. Among those that use any type of third party, close to 50% have the party make the investment selections either with (38%) or without (9%) the employer's approval. Another 29%

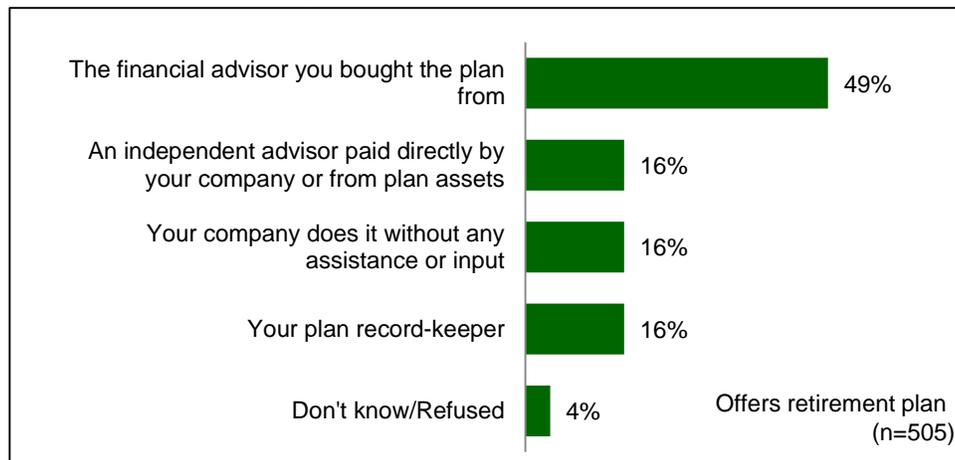
work collaboratively with the third party. Less than 25% take the lead in making the selections either with third party advice (20%) or just using the third party for implementation (3%).

Figure 6. Which best describes the role that the plan record-keeper/advisor plays?



When asked who plays the primary role in monitoring the performance of investments in the plan, 49% say it is the advisor who sold them the plan and 16% say that it is the plan record-keeper. Similarly, 16% say they do it themselves and another 16% hire an independent advisor. As with selecting investments, smaller companies (employee size 10-49) are less likely to use an independent advisor to monitor investments (only 11%) and larger companies (employee size 250-500) are less likely to use the plan provider advisor (34%).

Figure 7. Who plays the primary role in monitoring the performance of the investments in your retirement plan?



Views Towards Advisors and Record-keepers

As previous data suggests, most are satisfied with their plan line-up and rely greatly on their advisor or record-keeper for support in this area. Thus, it is not surprising that most give high grades to the advisor or record-keeper when it comes to working with the plan.

In the area of selecting or helping to select investments, over 80% evaluate this party as excellent (40%) or very good (42%). Another 13% rate this party as good. Only 4% evaluate the job done by this party as fair or poor. In the area of monitoring and, if necessary, changing the plan line-ups, 75% evaluate this party as excellent (35%) or very good (40%). Another 17% rate this party as good. Only 6% evaluate the job done by this party as fair or poor.

Figure 8. How good a job do you think your plan record-keeper/advisor does in selecting/helping you select investments for your retirement plan?

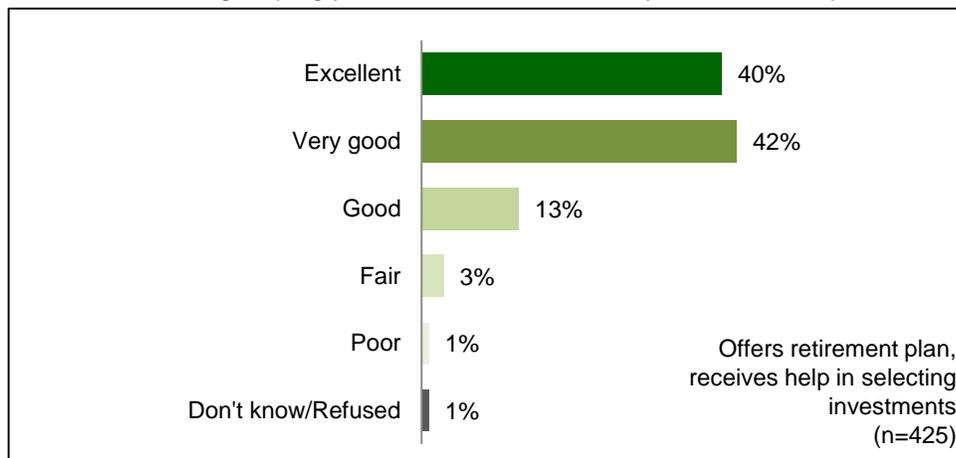
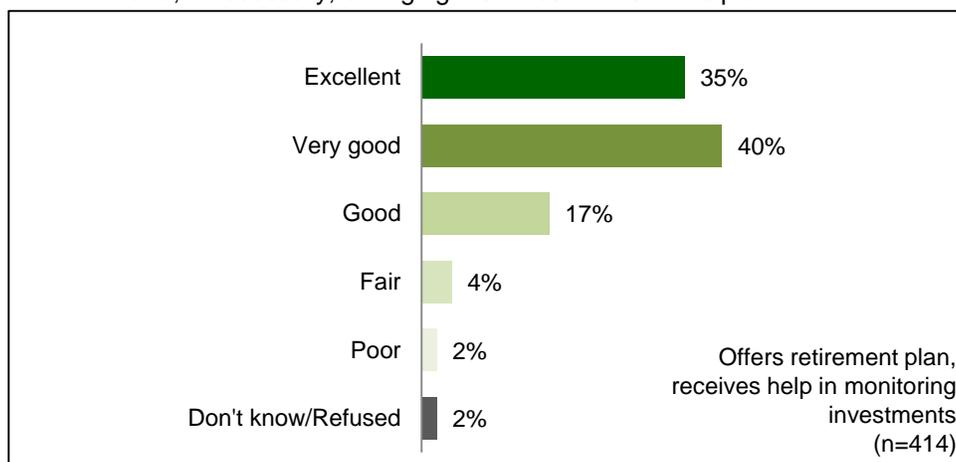


Figure 9. How good a job does your plan record-keeper/advisor do in monitoring and, if necessary, changing the investments in the plan?



In contrast, company retirement plan decision-makers give themselves low grades for doing investment functions themselves. When it comes to how they do in selecting investments for the plan or the job they would do if they were to play this role, 47% say that they do or would do a fair or poor job. Only 20% say they do or would do an excellent (6%) or very good (14%) job.

When it comes to how they do in monitoring and adjusting investments or the job they would do if they were to play this role, 53% say that they do or would do a fair or poor job. Only 18% say they do or would do an excellent (4%) or very good (14%) job.

Figure 10. How good a job do you do (or would you do) in selecting investments for the plan?

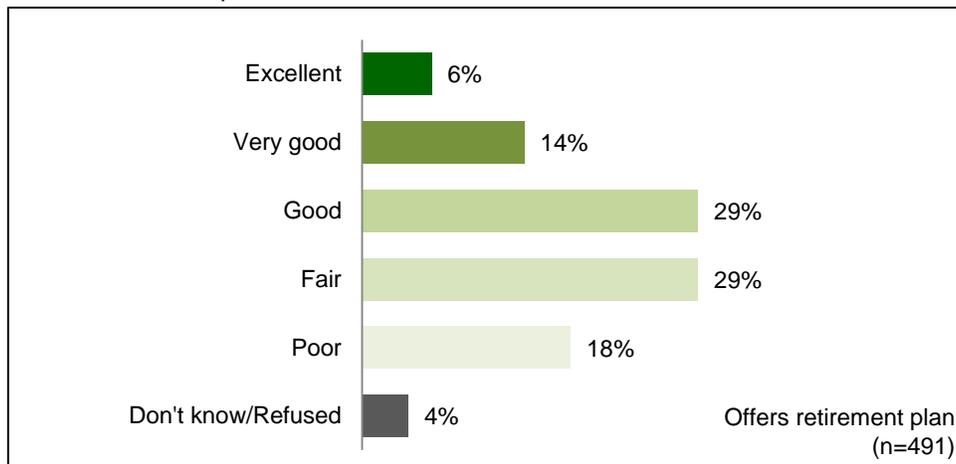
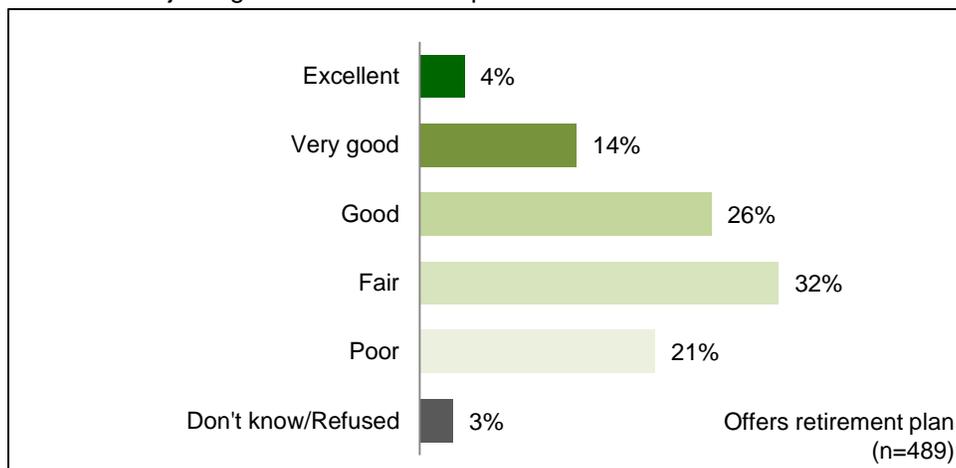


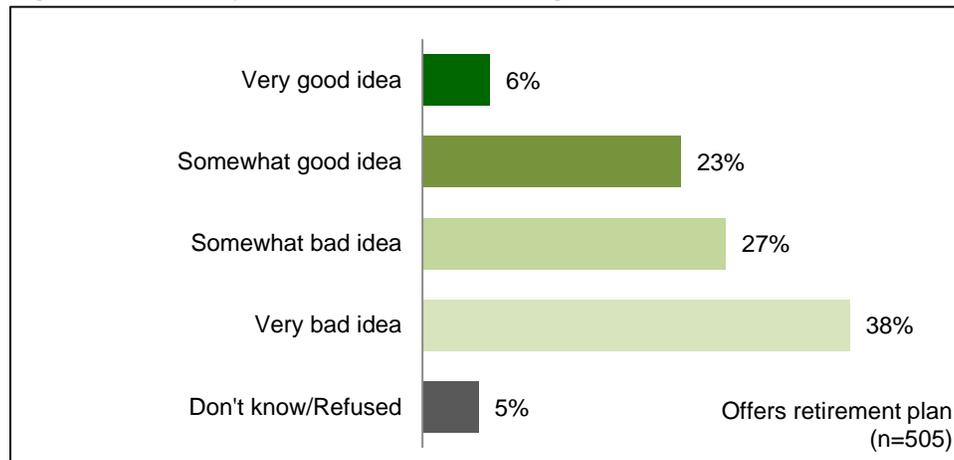
Figure 11. How good a job do you do (or would you do) in monitoring and adjusting investments in the plan?



Reaction to Proposed New Regulation

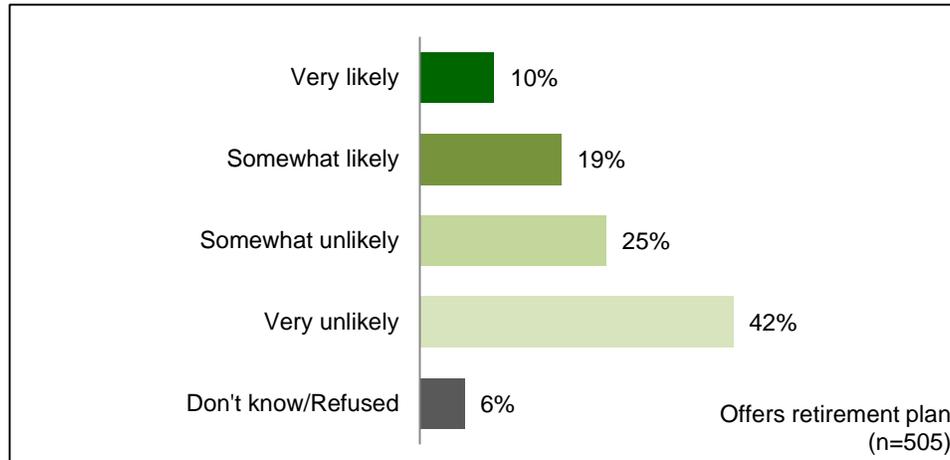
In general, small business plan decision-makers do not like the regulation proposed by the Department of Labor as presented to them. Respondents were given a description of the new regulation (See Appendix 1) and asked for their reaction. Overall, 65% consider it to be either a very bad idea (38%) or a somewhat bad idea (27%). Only about 29% consider it to be a very good idea (6%) or a somewhat good idea (23%). Larger companies (employee size 250-500) are more likely to think that the regulation is a good idea with 40% feeling it is at least a somewhat good idea. In contrast, only 26% of smaller companies (employee size 10-49) think the regulation is at least a somewhat good idea.

Figure 12. What is your reaction to this new regulation?



The research suggests several consequences that the new law might create. One is that a significant minority might drop their plans. When asked how likely they would be to drop their plan if this new regulation was implemented, close to 30% claim that it would be very likely (10%) or somewhat likely (19%) that they would. Over 65% say it is very likely (42%) or somewhat likely (25%) that they would not. Smaller companies (employee size 10-49) are the most likely to say that they would be very (13%) or somewhat (22%) likely to drop their plans.

Figure 13. If this regulation were implemented, how likely is it that you would drop your plan? Would you say that it is...



Another potential consequence is that many of these plan decision-makers may not trust their ability to choose the right advisor. When asked whether they would hire a third party to select and/or monitor funds, over 80% say that they would definitely (38%) or most likely (44%) do so. Only slightly over 10% would definitely (4%) or most likely (8%) do it themselves. Among this large majority that would hire another party, 76% are at least somewhat concerned about the fiduciary risk they might face in picking a firm that would not do a good job. Smaller companies (employee size 10-49) express the most concern with 82% being at least somewhat so.

Figure 14. If this regulation were implemented and you were to keep your plan, what would you do when it came to selecting and/or monitoring funds? Would you...

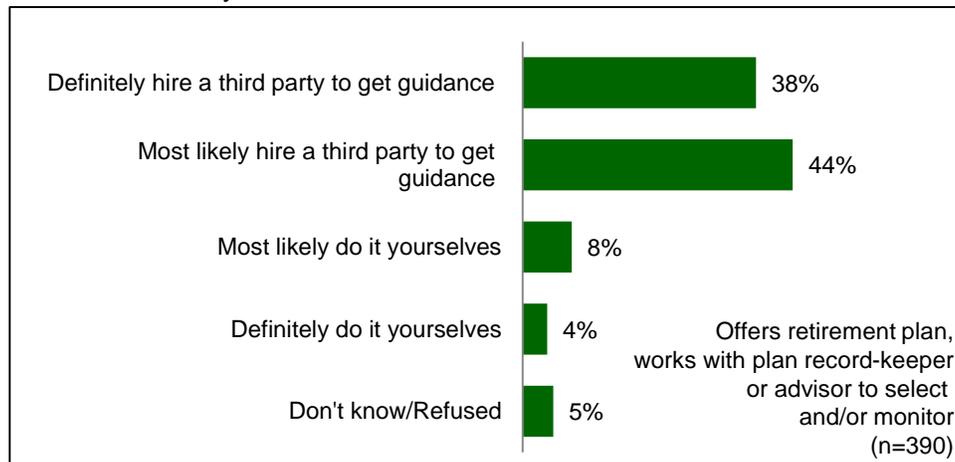
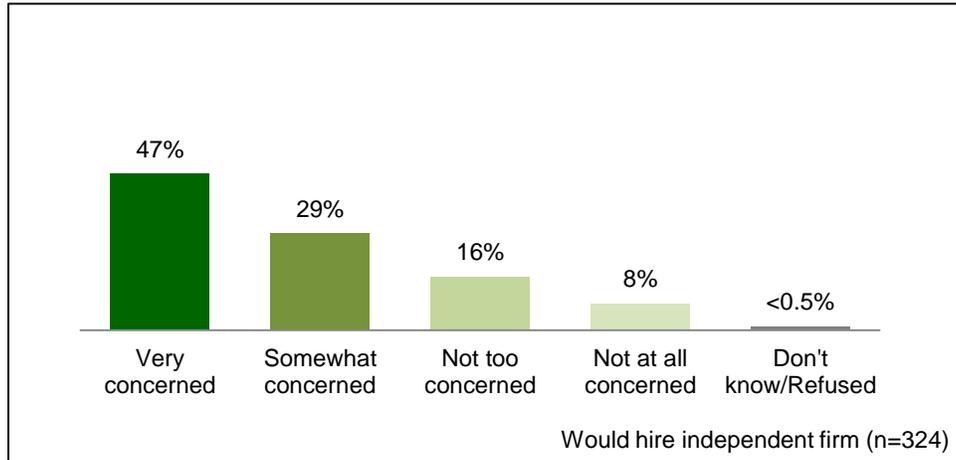
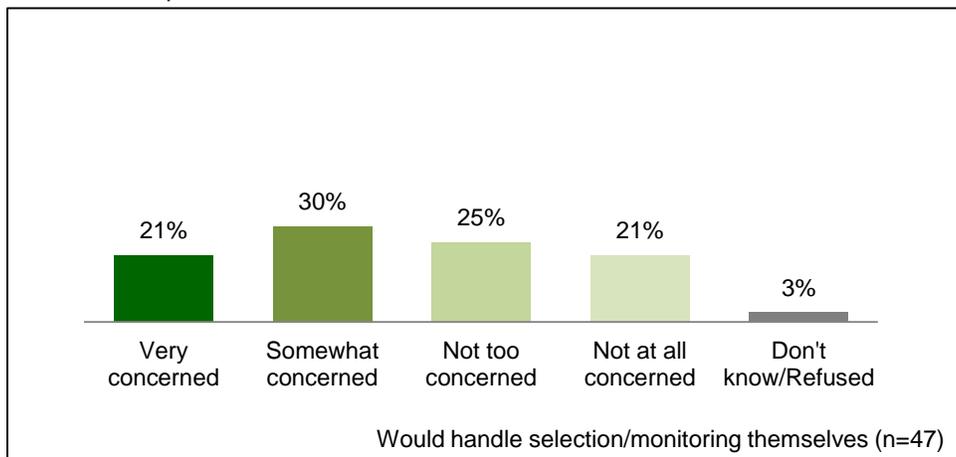


Figure 15. Assuming you were to hire an independent firm to select and/or monitor investments, how concerned would you be about the fiduciary risk you might face of picking a firm that would not do a good job?



Of the small minority who would select and/or monitor the investments themselves, 51% are very or somewhat concerned about the fiduciary risk they face of making bad decisions based on their lack of experience in the area.

Figure 16. Assuming you were to select and/or monitor investments yourself, how concerned would you be about the fiduciary risk you might face of making bad decisions or having liability based on your lack of experience in this area?

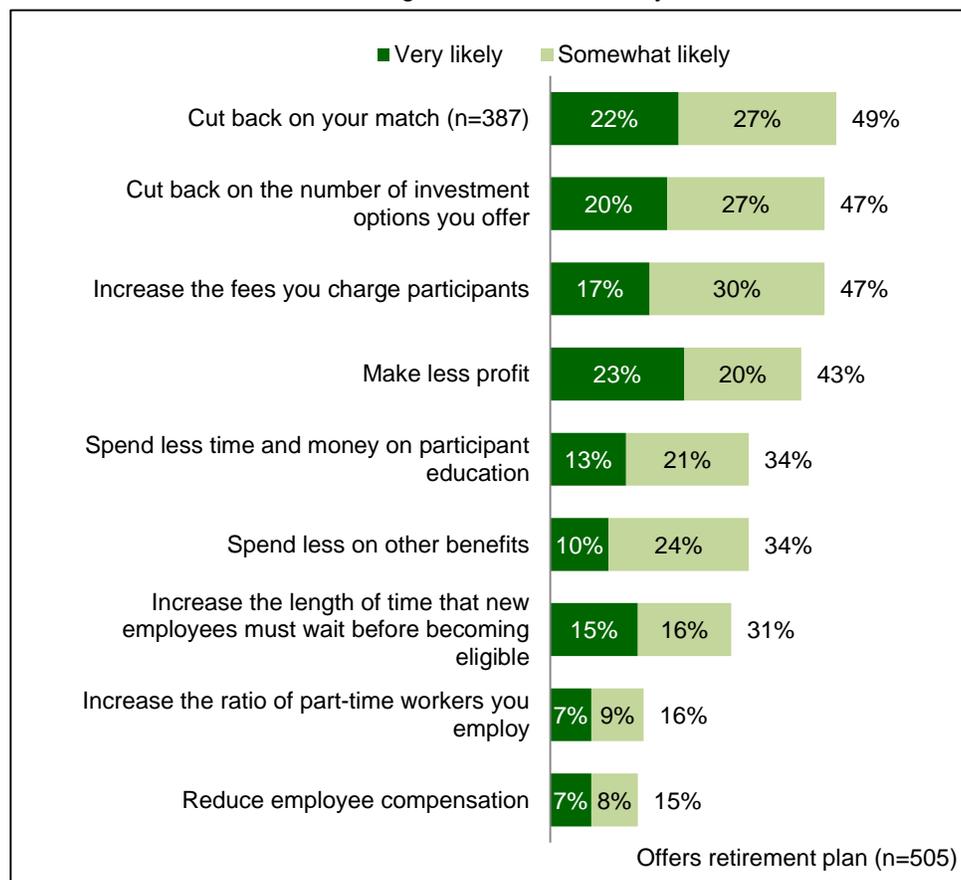


Even if small company plan managers do not drop their plans, this research suggest that significant numbers would take actions that would have negative financial consequences for their employees. Close to 50% each say that it is at least somewhat likely that they would cut back on their employee match (49%), that they would cut back on the number of investment options they offer (47%), and that they would increase plan fees (47%). Roughly 33% each say it would be at least somewhat likely that they would spend less on other benefits (34%), that they would spend less time on participant education (34%), and that they would increase the eligibility waiting time (31%) for the plan.

Smaller companies (employee size 10-49) are the most likely to consider making some of these cutbacks. Roughly 40% would spend less time and money on participant education (41%), spend less on other benefits (40%) and increase the eligibility waiting time (39%).

In addition, over 40% say that it is at least somewhat likely they would make less profit (43%).

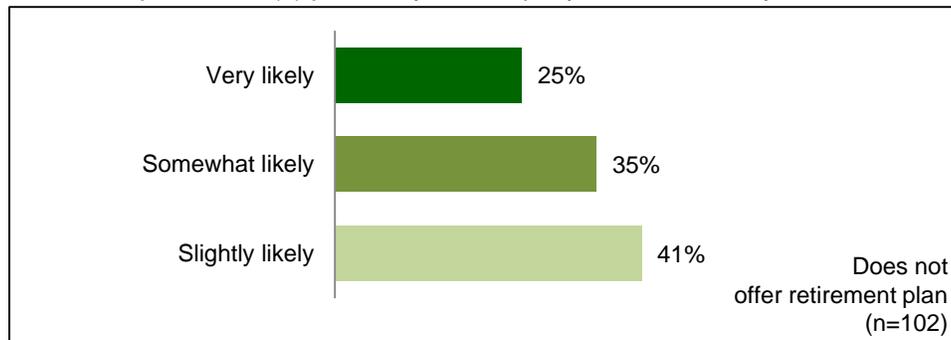
Figure 17. How likely is it that the increased cost and risk of fiduciary liability associated with this regulation would cause you to...



Impact of Regulation on Those Considering Starting a Plan

This study also interviewed 102 employers who would at least share in the decision-making authority to start a plan for their companies and who reported that they would be at least slightly likely to start a plan for their company. Of these, about 60% were at least somewhat likely to start a plan and 41% were slightly likely.

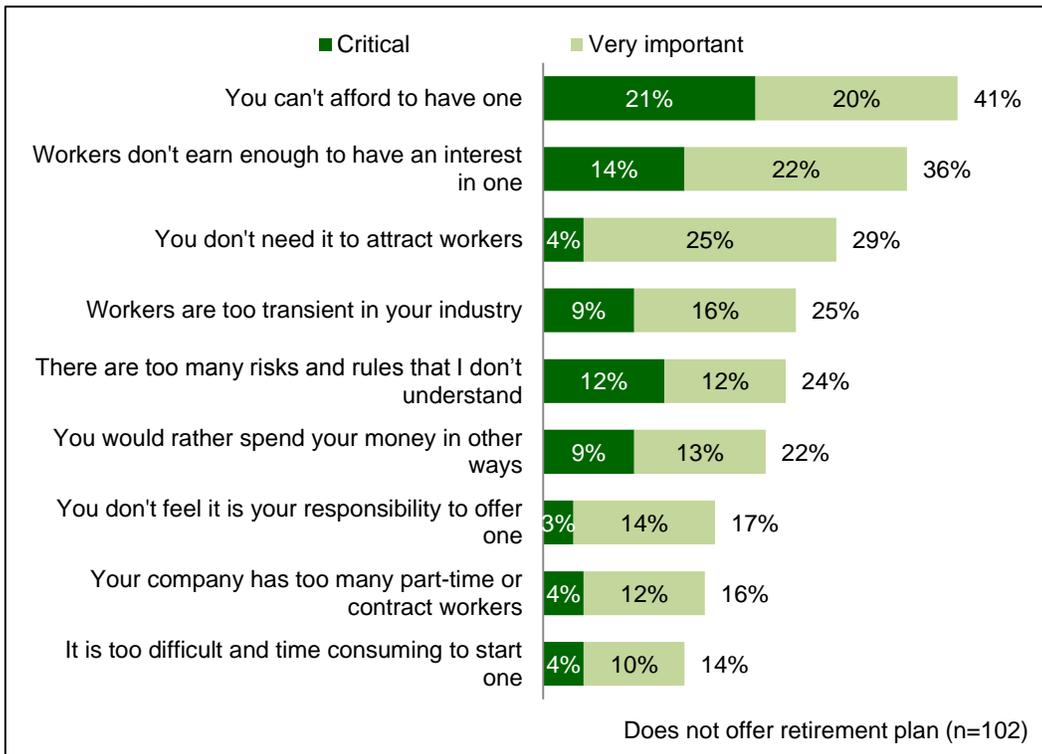
Figure 18. How likely is it that you will start a retirement plan, such as a 401(k) plan or 403(b) plan, for your company in the next five years?



Among these employers, the most common reason they do not start a plan is that they cannot afford to have one. Forty-one percent consider it to be a very important or critical reason. The second most important reason is that workers do not earn enough, with 36% of employers considering this to be at least very important. Other somewhat less frequently cited reasons include that they don't need it to attract workers and that workers are too transient.

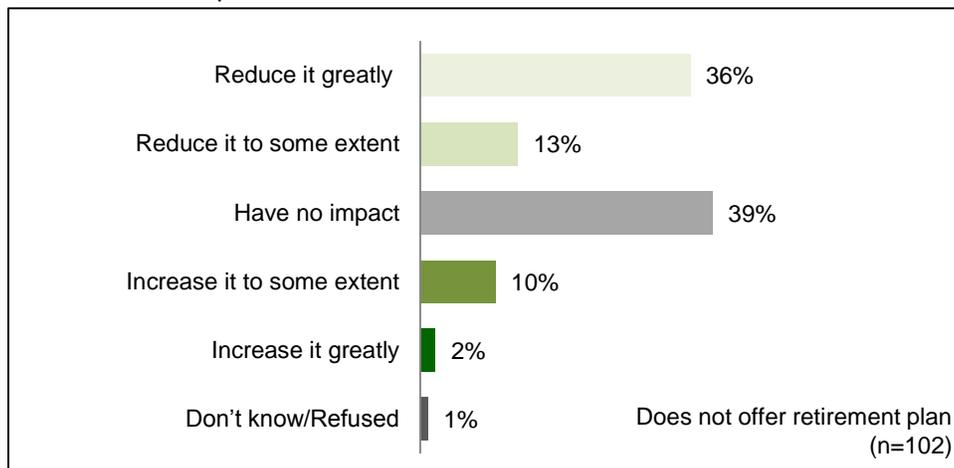
One interesting finding is that 24% cite the number of risks and rules that they don't understand as a very important or critical reason for not offering a plan.

Figure 19. How important are each of the following reasons for why you don't offer a plan...



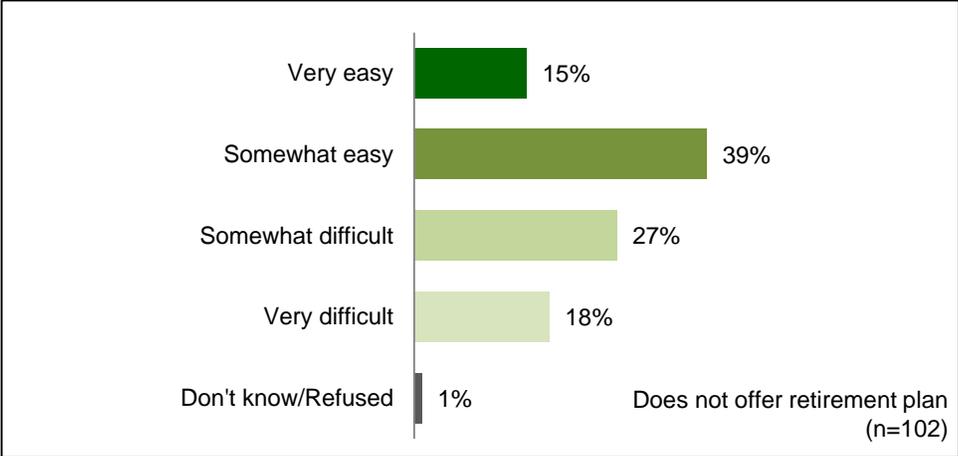
These employers were given the same description of the proposed Department of Labor regulation (See Appendix 1) and asked what impact such regulation would have on the likelihood that they would start a plan. Close to 50% claim that it would reduce their likelihood a great deal (36%) or to some extent (13%). Another 39% say it would have no impact. Twelve percent say it would increase their likelihood of starting a plan.

Figure 20. What impact would this new regulation have on your likelihood to start a new plan? Would it...



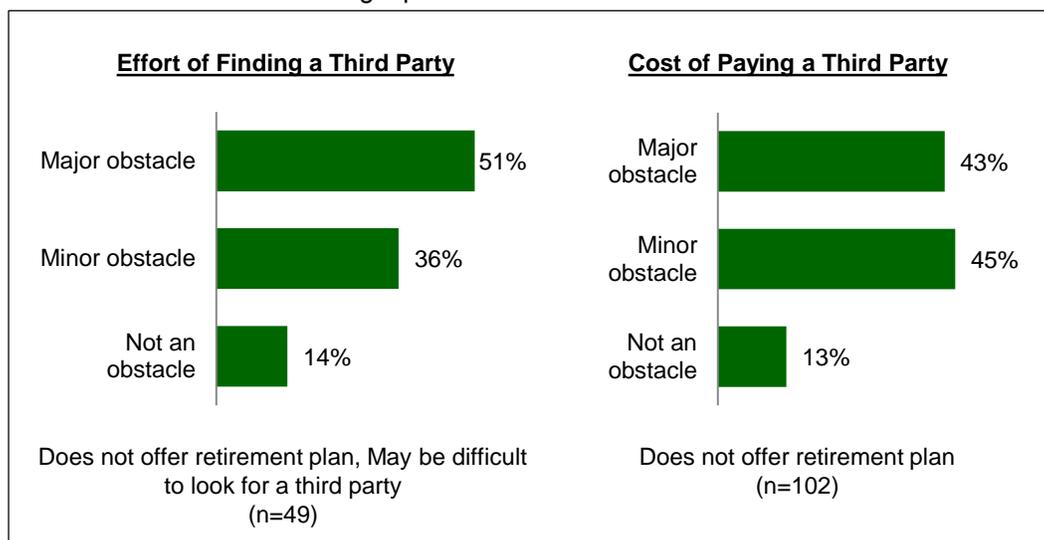
When asked how easy or difficult it would be to look for a third party expert they trust to provide investment guidance, over 50% of those responsible for the decision of starting a plan say it would be very (15%) or somewhat (39%) easy, and over 40% say that it would be very (18%) or somewhat (27%) difficult.

Figure 21. How easy or difficult do you think it would be to look for a third party expert you trust to provide guidance on the selection and monitoring of investment options...



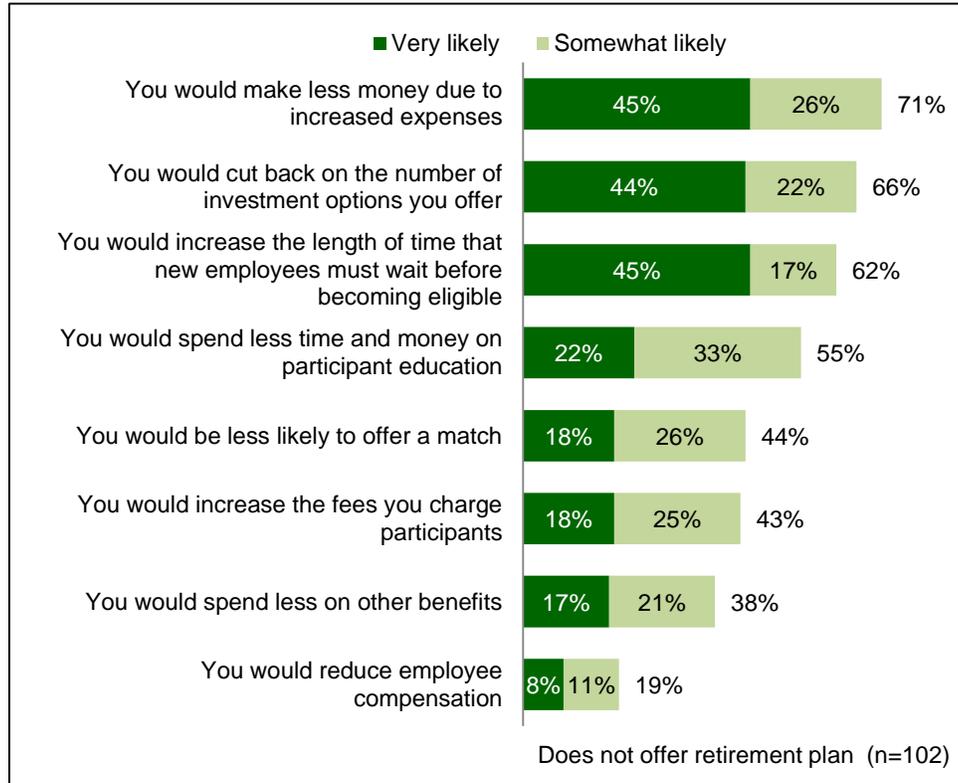
Nonetheless, the effort and cost involved in finding a third party expert does have a dampening effect on the likelihood of starting a plan. When asked how big an obstacle the effort and potential liability involved in finding a third party expert would be on their likelihood of offering a plan, 51% say that it would be a major obstacle. Forty-three percent say that the cost would be a major obstacle.

Figure 22. How big an obstacle would the effort and potential liability involved in finding a third party expert to provide guidance on the selection and monitoring of investment options be on your likelihood of offering a plan...
 How big an obstacle would the cost of paying a third party expert to provide guidance on the selection and monitoring of investment options be on your likelihood of offering a plan...



As with those already offering plans, the impact of the new regulation goes beyond the decision of whether or not to offer a plan for those considering one. It also impacts how generous the plan they are considering may be, and the impact is stronger than found for those already offering plans. Over 60% each say that the regulation would be at least somewhat likely to cut back on the number of investments they would offer (66%) and increase the eligibility waiting time (62%). Over 40% say they would be at least somewhat less likely to offer a match (44%) and at least somewhat likely to increase participant fees (43%). Seventy-one percent say it would cause them to make less money.

Figure 23. If you were to start a new plan, how likely is it that the cost and potential liabilities required by the new regulation would have the following impact...



Respondent Demographics

Figure 24. Average age of employee population

	Offers plan (n=505)	Does not offer plan (n=102)
30 or younger	11%	12%
31 to 35	19	34
36 to 40	24	25
41 to 45	27	11
46 or older	16	17
Don't know/Refused	3	1

Figure 25. Percentage of work force that is part time

	Offers plan (n=505)	Does not offer plan (n=102)
0%	31%	34%
1 to 9%	36	17
10 to 19%	10	14
20 to 29%	7	7
30 to 39%	5	11
40 to 49%	3	2
50 to 59%	3	2
60 to 69%	1	1
70 to 79%	2	4
80 to 89%	1	7
90 to 99%	<0.5	2
100%	--	--
Don't know/Refused	<0.5	--

Figure 26. Types of retirement plans offered

	Offers plan (n=505)
401(k) plan	84%
403(b) plan	13%
Profit sharing plan	24%
ESOP or stock bonus plan	5%
Some other type of retirement plan	15%

Figure 27. Percentage of full-time employees that are eligible to participate in 401(k) or 403(b) plan(s)

	Offers 401(k) or 403(b) (n=484)
Less than 10%	<0.5%
10 to 19%	1
20 to 29%	1
30 to 39%	<0.5
40 to 49%	2
50 to 59%	3
60 to 69%	3
70 to 79%	6
80 to 89%	9
90 to 99%	19
100%	55
Don't know/Refused	1

Figure 28. Percentage of plan participants that are currently contributing part of their income to the plan(s)

	Offers 401(k) or 403(b) (n=484)
Less than 10%	5%
10 to 19%	5
20 to 29%	7
30 to 39%	7
40 to 49%	7
50 to 59%	10
60 to 69%	11
70 to 79%	14
80 to 89%	11
90 to 99%	10
100%	10
Don't know/Refused	2

APPENDIX 1

Description of Proposed Regulation

Now I want to describe a proposal for a new government regulation. As a plan sponsor, your company currently has a fiduciary responsibility to act in the best interest of your employees when it comes to the investment choices that are available in the company retirement plan. This includes using a prudent process to select a reasonable group of investment funds and monitoring fund performance. Companies have liability to the extent that they do not meet their fiduciary duties.

Currently, many employers depend on their plan provider or advisor to provide assistance on the selection and monitoring of funds they offer employees. Such use of assistance is permissible under the fiduciary rules as long as it is prudent to do so. The Department of Labor is considering prohibiting both retirement plan providers and the advisors who sell retirement plans to employers from assisting the employers in the selection and monitoring of the funds in the retirement plan. Under possible new rules, the employer would have two options: (a) find an independent expert on investments to provide, for an additional fee, guidance on the selection and monitoring of investment options, or (b) do the selection and monitoring themselves, subject to fiduciary liability if this selection is not done in a prudent manner by someone with sufficient expertise. If “a” is chosen, the plan sponsor would be subject to fiduciary liability if the expert is not chosen in a prudent manner.

The role of financial advisors in the US retirement market

JULY 10, 2015

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About this report

There has been substantial public debate recently about the value of financial advice and the importance of financial advisors. Many people continue to believe financial advisors perform a critical service helping individuals and small businesses successfully navigate complex financial challenges. Others have sought to portray financial advisors as self-interested salesmen and saleswomen, who provide conflicted advice to sell high cost products. Against this background, Oliver Wyman was engaged to perform a rigorous investigation of the role of financial advisors in the US retirement market, and quantify differences in investing behavior and outcomes between advised and non-advised individuals.

In this report, Oliver Wyman focuses on understanding the impact of financial advisors on individuals saving for retirement and small businesses setting up and maintaining a workplace sponsored retirement plan. Through a combination of proprietary research with individuals and small businesses and analysis of unparalleled datasets from IXI (a division of Equifax), we found that advised individuals and small businesses are better off in many of the ways that matter most for superior investing outcomes.

The benefits financial advisors provide are now at risk. On April 14, 2015, the Department of Labor issued its Conflict of Interest rule proposal, a replacement for the Definition of the Term “Fiduciary” rule proposal withdrawn in September 2011. The new Conflict of Interest Rule proposal, like its predecessor, would greatly expand the range of conditions under which an individual who provides investment services would be subject to ERISA fiduciary rules. The new proposal goes further in some respects. It explicitly defines promotional services provided to IRA account holders and small businesses as advice subject to ERISA fiduciary rules. While many stakeholders are analyzing the technical details and implications, this study considers the impact on individuals and small businesses that use financial advisors. We conclude that the newly proposed rule, while well intended, would have significant negative consequences for many retail investors if implemented with regard to the availability and cost of retirement savings help and support.

Further details on our research sources and methodology

1. Proprietary research, including two surveys of 4,393 retail investors and 1,216 small businesses;
2. Two datasets provided by IXI Services representing approximately 20% (\$5.6 Trillion in 2013) of U.S. consumer invested assets on a household level and approximately 30% (\$9.7 Trillion in 2013) of U.S. consumer invested assets on

3. an account level, respectively. This data is broken into different types of investment holdings for specific age, income and wealth segments as well as between individuals with, and without, a financial advisor;
4. Widely available secondary data sources.

Analyses based on data from the Oliver Wyman Retail Investor Retirement Survey and IRI invested assets datasets have been controlled for factors such as income, age, and assets to ensure they are representative of particular segments of the US retail investor population. In addition, responses from the retail investor survey were further scaled based on the 2013 Federal Reserve Survey of Consumer Finances to produce a representative sample of US retail investors. Unless indicated otherwise, small businesses are defined as businesses with established payroll and up to 100 employees. For additional information regarding our approach and market research, please refer to the methodology section of this document contained in the appendices.

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Executive summary

Oliver Wyman's study of the role of financial advisors in the US retirement system draws upon proprietary surveys of more than 4,300 retail investors and 1,200 small businesses, datasets from IXI Services (a division of Equifax), representing approximately 20% of U.S. consumer invested assets on a household level and approximately 30% of U.S. consumer invested assets on an account level, to provide a unique window into the value financial advisors provide to small businesses and retail investors for their retirement savings and investments needs.

With fewer individuals covered by corporate pension plans and the future of social security uncertain¹, individuals are increasingly responsible for providing for their own retirement. Workplace-sponsored defined contribution (DC) plans offer significant tax and other advantages to foster increased retirement savings. Indeed, 84% of individuals began saving for retirement via a workplace retirement plan.² When available, they are often the primary vehicle for personal retirement savings. However, over 19 million people who work for businesses with fewer than 50 employees do not currently have access to a workplace retirement plan.

We found that financial advisors are often a key advisor to small businesses, helping business owners through the process of setting up a defined contribution plan for their employees. When a financial advisor is involved, small businesses with 10-49 employees are 50% more likely to set up a workplace retirement plan. In addition, micro businesses (1-9 employees) that work with a financial advisor are nearly twice as likely to set up a plan.

Recognizing the growing importance of workplace DC plans, there have recently been a number of innovations that have doubtlessly improved the retirement outcomes for millions of people, including automatic enrollment and rebalancing features, better default investment options and in-plan advice. Yet, in spite of these improvements, many individuals continue to under-save (the average default contribution rate for plans with automatic enrollment is 3.4%³ vs. the 6-10% recommended by many experts).

Many people are uncomfortable tackling retirement savings on their own. By one measure, 58% of households with under \$100,000 in investable assets, and 75% of households with over \$100,000 in investable assets solicit professional financial advice⁴.

¹ Social Security Administration, (<http://www.ssa.gov/policy/docs/ssb/v70n3/v70n3p111.html>): "Benefits are now expected to be payable in full on a timely basis until 2037, when the trust fund reserves are projected to become exhausted...[at that point] continuing taxes are expected to be enough to pay 76 percent of scheduled benefits."

² Oliver Wyman Retail Investor Retirement Survey 2014

³ Center for Retirement Research at Boston College, 'How Does 401(K) Auto-Enrollment Relate To The Employer Match And Total Compensation?', (http://crr.bc.edu/wp-content/uploads/2013/10/IB_13-14.pdf), October 2013

⁴ 2013 Survey of Consumer Finances

Advised individuals place the largest value on financial advisors' support for financial planning, monitoring and providing trusted advice for their holistic financial needs.

In this regard, we found that many investors prefer to seek help from financial advisors outside their workplace in part to receive holistic advice on their assets. When changing jobs, individuals often choose to roll over assets into an IRA, primarily to consolidate assets and avoid leaving assets with a former employer. Just 29% of individuals own 401(k) plans exclusively, while nearly two-thirds hold assets outside their workplace in combination with an IRA or alone in one or more IRAs.

How well are financial advisors doing their job? On average, we found that individuals with a financial advisor have more wealth than non-advised individuals across all age and income levels studied. For example, we found that advised individuals aged 35-54 years making less than \$100K per year had 51% more assets than similar non-advised investors. These are typical middle-class households in the middle of their accumulation years. Moreover, advised individuals are better investors across many key dimensions commonly associated with long term investing success. Specifically, we found that compared with individuals without a financial advisor, advised individuals

- Own more diversified investment portfolios
- Stay invested in the market by holding less cash and cash equivalents
- Take fewer premature cash distributions; and
- Re-balance their portfolios with greater frequency to stay in line with their investment objectives and risk tolerance.

The benefits financial advisors provide to their clients are now at risk. On April 14, 2015, the Department of Labor issued its Conflict of Interest rule proposal, a replacement for the Definition of the Term "Fiduciary" rule proposal withdrawn in September 2011. In our 2011⁵ study reviewing the impact of the previously proposed rule, we concluded that the Department of Labor's proposed rule change was motivated by a laudable objective: to ensure a high standard of care for retirement plan participants and account holders with regard to the receipt of services and investment guidance, amid an increasingly complex financial marketplace. However, we found the proposed rule proposal was likely to have serious negative and unintended effects on the very individuals the change was supposed to help.

Many stakeholders are now analyzing the technical details of the newly proposed rule, and there is growing concern that the proposal would again result in unintended

⁵ Oliver Wyman, 'Assessment of the Impact of the Department of Labor's Proposed "Fiduciary" Definition Rule on IRA Consumers', 2011

consequences, including limiting the ability of financial services firms and individual financial advisors to offer services to individual IRA holders and small businesses, as well as increasing investor costs due to new expenses associated with implementing the rule and transitioning many clients to a higher cost advisory model.

With regard to the impact on individuals, regrettably we reach the same overall conclusion as in the prior study. The proposed rule change is likely to have significant consequences that will adversely impact individual investors saving for retirement. For example, because the rule as proposed will take away the assistance small businesses most value, fewer new plans will be established and more plans will likely close⁶. This would directly impact the 19 MM individuals who work for small businesses with fewer than 50 employees, who do not currently have access to a workplace retirement plan and reduce the likelihood of their gaining access to a retirement plan in the future.

In the case of IRAs, if the rule is implemented as proposed⁷

- Millions of existing small balance IRA owners are likely to lose access to the financial advisor of their choice or any financial advisor at all
- The majority of others will face higher costs when providers shift brokerage accounts to advisory accounts
- Individuals without the help and support of financial advisors are less likely to open an IRA, leading to increased cash-outs when changing jobs and lower savings rates compared with advised individuals⁸
- Unadvised individuals are likely to carry excess portfolio risk due to less diversification and less frequent re-balancing.

* * *

⁶ The new rule proposal explicitly excludes small businesses with fewer than 100 employees with employee-directed plans from the prohibited transaction exemption, otherwise made available to larger plans. This will force financial advisors to limit the services they currently provide to such small businesses in connection with establishing and maintaining retirement plans.

⁷ See Oliver Wyman, 'Assessment of the Impact of the Department of Labor's Proposed "Fiduciary" Definition Rule on IRA Consumers', 2011

⁸ Prior guidance from the DOL "held that recommendations to a plan participant to take an otherwise permissible distribution, even combined with a recommendation as to how to invest distributed funds, is not fiduciary investment advice." K&L Gates, DOL Re-Proposes Rule to make Brokers, Others, ERISA Fiduciaries (Apr. 27, 2015), <http://www.klgates.com/dol-re-proposes-rule-to-make-brokers-others-erisa-fiduciaries-04-27-2015>.

Retirement is too important to get wrong. We encourage key stakeholders from the financial services industry and regulators to join together to find workable solutions that preserve individuals' access to help and support from a financial advisor of their choice as well as the business model and fee structure that best meet their needs.

Key findings

Workplace sponsored defined contribution plans are critical retirement savings vehicles

- 84% of individuals began saving for retirement via a workplace retirement plan⁹
- Workplace sponsored defined contribution plans represent the primary or only retirement vehicle for 67% of individuals who save for retirement with a tax-advantaged retirement plan¹⁰

Financial advisors help individuals that work for small businesses gain access to workplace retirement plans

- 19 million individuals who work for small businesses with fewer than 50 employees do not currently have access to a workplace sponsored retirement plan
- Small businesses that work with a financial advisor are 50% more likely to set up a retirement plan (and micro business with 1-9 employees are almost twice as likely)

The majority of retail investors seek financial advice – many want personalized services from a professional financial advisor outside their workplace for financial planning and holistic advice and support on all their investment holdings

- 58% of households with under \$100,000 in investable assets, and 75% of those with over \$100,000 in investable assets solicit professional financial advice
- Individuals most value financial advisors for support with financial planning, monitoring and trusted advice for their holistic financial needs
- Many individuals currently have access to help and advice on their plan assets through workplace retirement plans; those that use it save 43% more on average. However, fewer than half of workplace retirement plan participants currently use in-plan advice features

⁹ Oliver Wyman Retail Investor Retirement Survey 2014

¹⁰ Oliver Wyman Retail Investor Retirement Survey 2014

- Two-thirds of investors have retirement savings outside of employer-sponsored retirement plans, and many seek advice and support from a professional advisor outside their workplace for all of their investment holdings

Advised investors have more assets than those without a financial advisor

- We found that advised individuals have a minimum of 25% more assets than non-advised individuals
- In the case of individuals aged 35-54 years with \$100,000 or less in annual income, advised individuals have an average of 51% more assets than non-advised individuals

Individuals with a financial advisor are better long term investors

- Advised investors have more diversified portfolios -- own twice as many asset classes, have more balanced portfolio asset allocations and use more packaged products for equity exposure compared with non-advised investors
- Advised investors stay more invested in the market – Advised individuals hold less cash in their investment accounts (36%-57% less than non-advised individuals for similar age and wealth cohorts)
- Advised investors re-balance more frequently, and are 42% more likely to re-balance their portfolios at least every two years

The Department of Labor’s proposed Conflict of Interest rule would likely reduce retirement savings

- As proposed, financial advisors would be forced to stop providing workplace retirement plan set-up and support services to small businesses, due to the lack of an exception that would allow providers to market to self-directed plans with fewer than 100 participants, which will likely result in many small businesses closing existing plans or not establishing new plans due to the additional administrative burden
- Individuals with small balance accounts that are below standard advisory account minimums are likely to lose access to retirement help and support with selecting appropriate products as a result of providers shifting accounts from brokerage to fee-based advisory accounts. In our prior study, we estimated that 7 MM current IRAs would not qualify for an advisory account due to low balances¹¹

¹¹ Oliver Wyman, ‘Assessment of the Impact of the Department of Labor’s Proposed “Fiduciary” Definition Rule on IRA Consumers’, 2011

- Almost all retail investors face increased costs (73% to 196% on average) from providers shifting clients to a fee-based advisory model. In our 2011 study, we found nearly 90% of the 23 MM IRAs analyzed were held in brokerage accounts¹²
- When changing jobs, individuals will be less likely to open an IRA to manage their plan savings, leading to lower savings rates and increased cash-outs¹³. In our 2011 study, we found that as many as 360,000 fewer IRAs would be opened every year
- Unadvised individuals will likely carry excess portfolio risk due to less diversification and less frequent re-balancing compared with advised individuals

¹² Oliver Wyman, 'Assessment of the Impact of the Department of Labor's Proposed "Fiduciary" Definition Rule on IRA Consumers', 2011

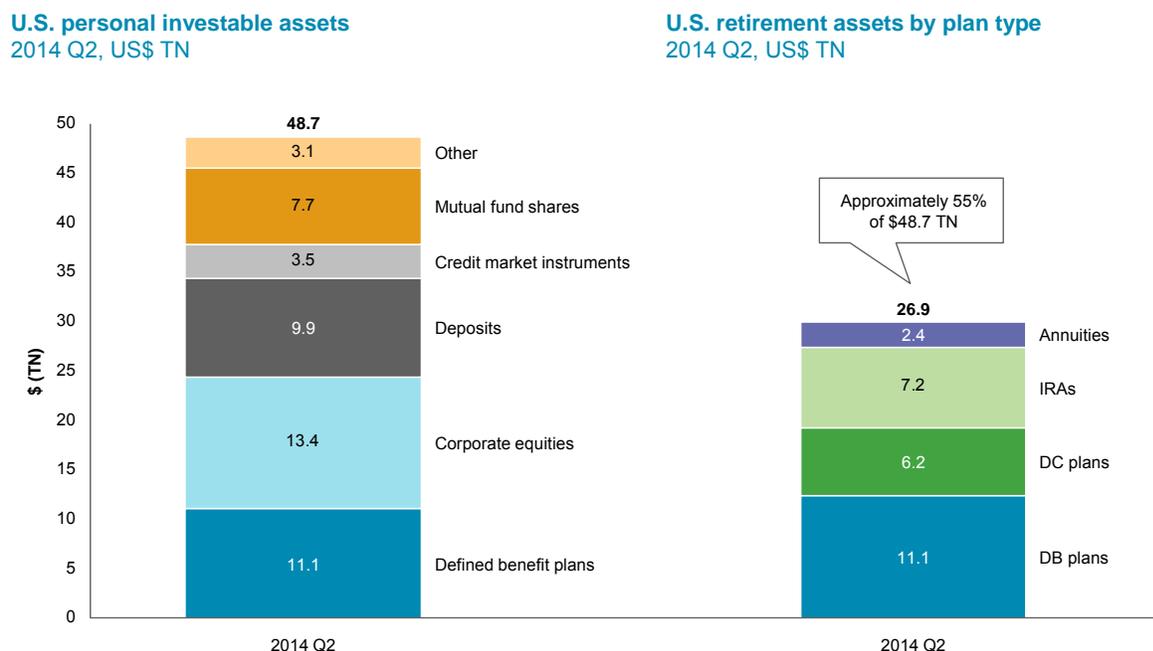
¹³ Prior guidance from the DOL "held that recommendations to a plan participant to take an otherwise permissible distribution, even combined with a recommendation as to how to invest distributed funds, is not fiduciary investment advice." K&L Gates, DOL Re-Proposes Rule to make Brokers, Others, ERISA Fiduciaries (Apr. 27, 2015), <http://www.klgates.com/dol-re-proposes-rule-to-make-brokers-others-erisa-fiduciaries-04-27-2015>.

I. Role of financial advisors in the defined contribution plan market

Two-thirds of retirement assets are held in workplace retirement plans

At an estimated \$26.9 TN, US retirement savings represent over half of total personal investable assets. Of this amount, workplace sponsored retirement plans such as defined benefit (DB) and defined contribution (DC) plans constitute approximately two-thirds of retirement assets, while the remaining one-third is held in IRAs and annuities (Figure 1).

Figure 1: US personal investable assets and retirement assets¹⁴



Individuals are increasingly responsible for saving for their own retirement

Nearly five times as many individuals are active participants in DC plans as compared to DB plans as of 2012 (75.4 million vs. 15.7 million).^{15,16} Moreover, as Figure 2 shows,

¹⁴ Federal Flow of Funds L.116, B.100: Includes financial assets and defined benefit assets; excludes agency and GSE backed securities, other loans and advances, mortgages, consumer credit (student loans), pension entitlements and equity in non-corporate business

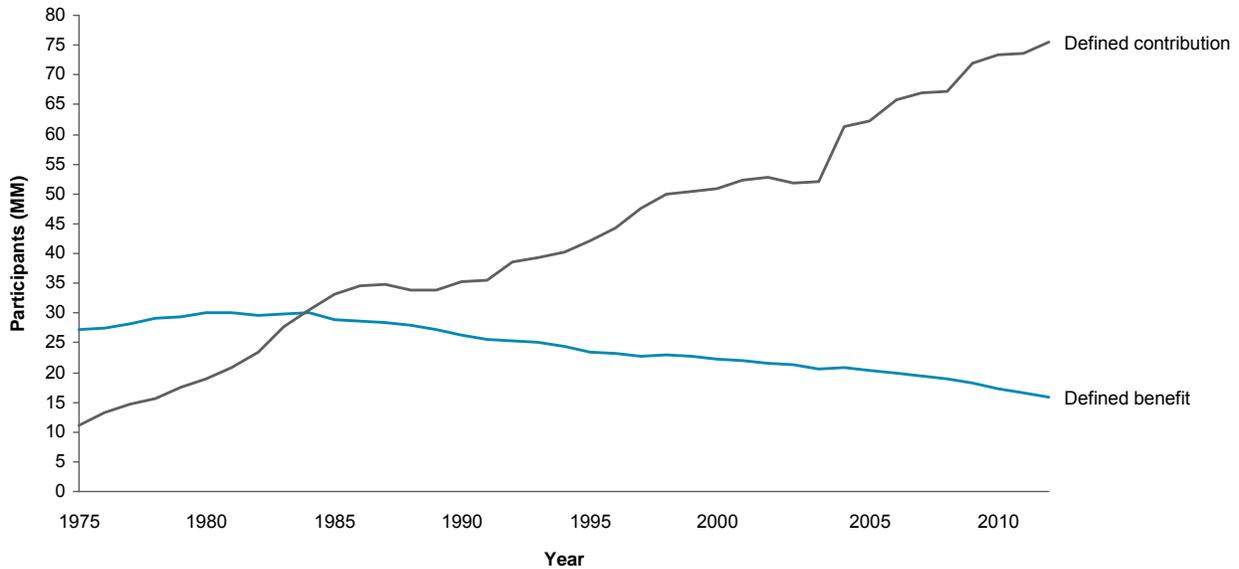
Federal Flow of Funds L.116: Retirement assets include household retirement assets

¹⁵ Private Pension Plan Bulletin Historical Tables and Graphs, U.S. Department of Labor, Employee Benefits Security Administration, December 2014

¹⁶ Note: Aggregation methodologies were changed in 2004 and 2009, generating anomalies for those years

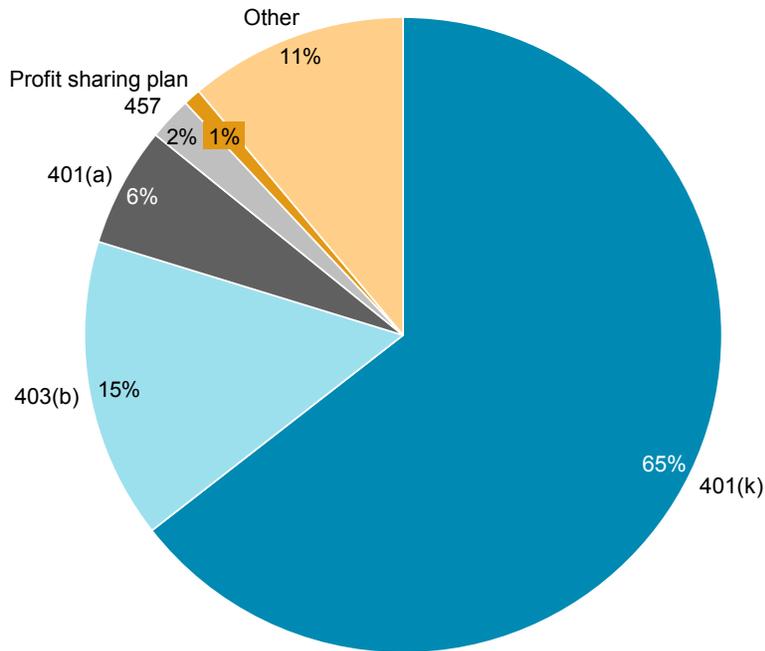
the long-term trend continues to favor DC plans. As a result, the level of retirement assets available to individuals is now dependent upon a number of factors both within and outside their control, including employment status, personal contribution rate, the availability of employer matching contributions, investments selected and market performance.

Figure 2: Active retirement plan participants (see footnotes 8,9)



Within the broad category of defined contribution plans, there are a number of different vehicles such as 401(k), 403(b), 401(a), 457 and profit sharing plans with different features to suit the needs of a wide range of business plan sponsors and individuals. As illustrated in Figure 3, the most popular vehicle by share of assets is the 401(k).

Figure 3: Defined contribution assets by plan type (2013 YE)¹⁷



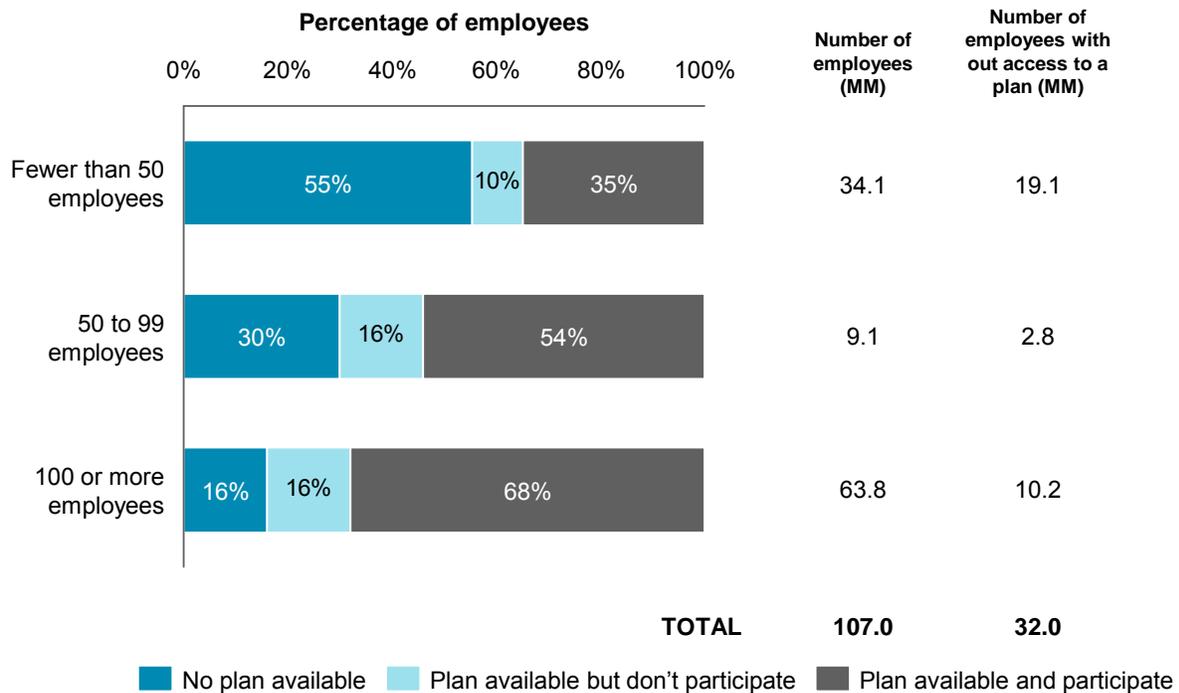
Based on our retail investor survey, we found that workplace retirement plans are vital for individuals to start saving for retirement – 84% of respondents began saving for retirement via a workplace retirement plan.

More than 80% of retail investors surveyed began saving for retirement through workplace retirement plans

¹⁷ Pensions & Investments Research Center: (<http://researchcenter.pionline.com/rankings/dc-money-manager/plantype/2014?limit=213>)

As of 2013, approximately 75 million, or 70% of the 107.0 million full-time and part-time US private sector workers, had access to a workplace retirement plan, and 60 million, or 56% of 107.0 million, chose to participate. Of the 32 million private sector workers without access, nearly two-thirds, or 19 million, are employed by small businesses with fewer than 50 employees (Figure 4).¹⁸

Figure 4: Workplace retirement plan access and participation among private sector workers, W-2 adjusted rates, by firm size (2013)



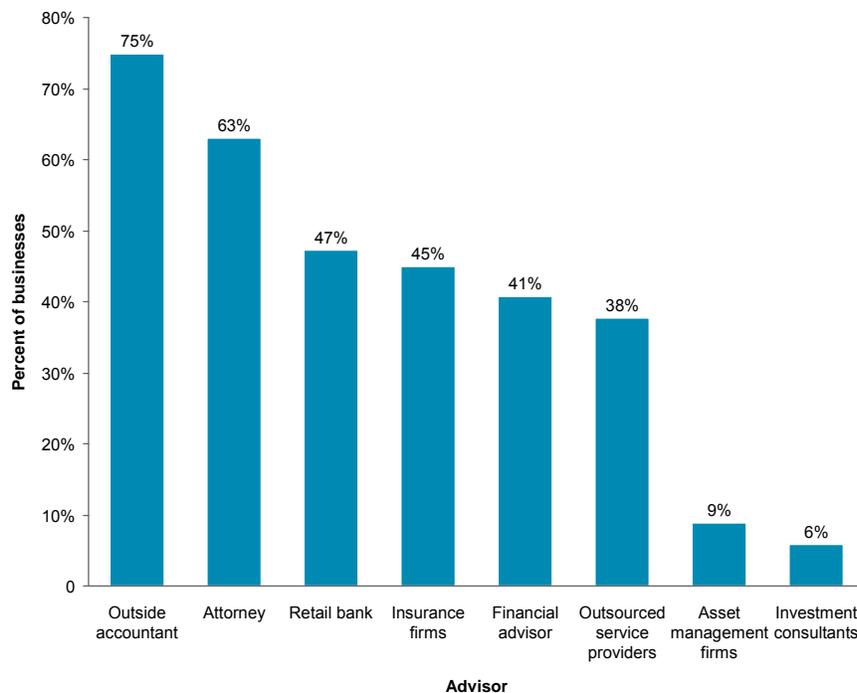
¹⁸The number of employees by firm size is based on Investment Company Institute tabulations of the US Census' Current Population survey (www.ici.org/info/per20-06_data.xls). We use W-2 adjusted self-reported access and participation rates, as compiled by Dushi, Iams, and Lichtenstein ('Assessment of Retirement Plan Coverage by Firm Size Using W-2 Tax Records', Social Security Administration, 2011, <http://www.ssa.gov/policy/docs/ssb/v71n2/v71n2p53.pdf>). This study accounts for under- and over-reporting of plan participation by using individual tax filings to identify tax-deferred contributions, and avoids the issues of double-counting of individuals active in more than one plan and non-active participants in plans with short-form filings associated with available DOL data.

Our research provides interesting insights into reasons for the lower availability rates of workplace retirement plans among small businesses. When asked to select their reasons for not offering a plan, we found that cost (47% of small business survey respondents), prioritization of other employee benefits (24%) and significant use of temporary labor (20%) were the most commonly cited barriers to DC plan formation.

Barriers to small business plan formation include cost, prioritization of other benefits and temporary labor

In contrast to large businesses that often employ investment consultants to assist internal governance committees with managing a DC plan, small businesses typically rely on a circle of trusted advisors. We found small businesses most commonly seek advice from a range of providers including accountants, attorneys, retail banks, insurance firms, financial advisors, and outsourced service providers. Figure 5 shows the prevalence of these advisors among small businesses.

Figure 5: Prevalence of different advisor types among small businesses¹⁹



¹⁹ Oliver Wyman Small Business Retirement Survey 2014, Respondents were asked to select all of the advisors that they consult in the management of their business, hence the sum is greater than 100%. Participants were asked to select from the following options: outside accountant (CPA), outsourced service, financial advisor (e.g. Merrill Lynch, Morgan Stanley, Independent financial professional), asset management firms (e.g. Vanguard, T. Rowe Price), attorney, retail bank (other than private banks and brokerages within banks, e.g. JPMorgan Chase, Bank of America, HSBC, Citibank), investment consultants (e.g. Aon Hewitt, Mercer), insurance firms (e.g. Aetna, Nationwide), and none (I am solely responsible for all business decisions).

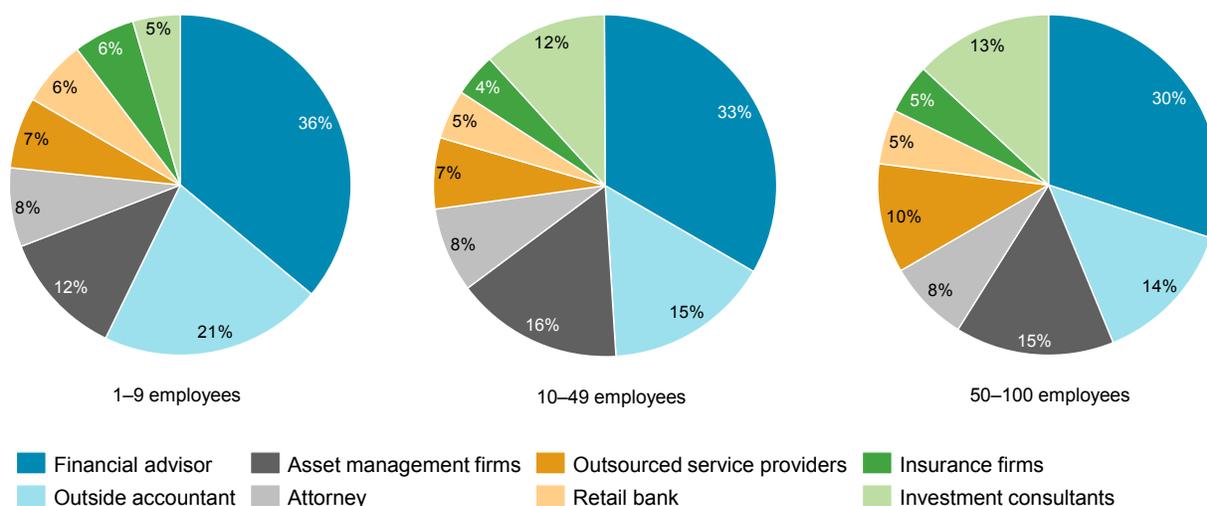
Financial advisors help small businesses set up workplace retirement plans

Small businesses use advisors for a range of services for their DC plans, which vary from plan to plan and from advisor to advisor. Examples of typical services include:

- Development of an investment policy statement covering aspects such as plan objectives, investment philosophy and risk appetite
- Plan design consulting (e.g. choice of funds, use of auto-enrollment, QDIA, auto-escalation, and employer matching program), and selection of a record-keeper
- Participant education and support (e.g. general help and support around plan participation, contribution rates and investment options, investment planning and IRA rollovers).

Small businesses perceive financial advisors to be most helpful with respect to guidance on retirement plan setup and administration. We asked survey respondents to allocate 100 points among their different advisors based upon the value they assigned to their help and support in choosing to set up a workplace retirement plan. As shown in Figure 6, this statement holds true across all types of advisors and business sizes with small businesses allocating between 30% and 36% of value to financial advisors.

Figure 6: Value of advice attributed to advisors in choosing to set up a retirement plan²⁰

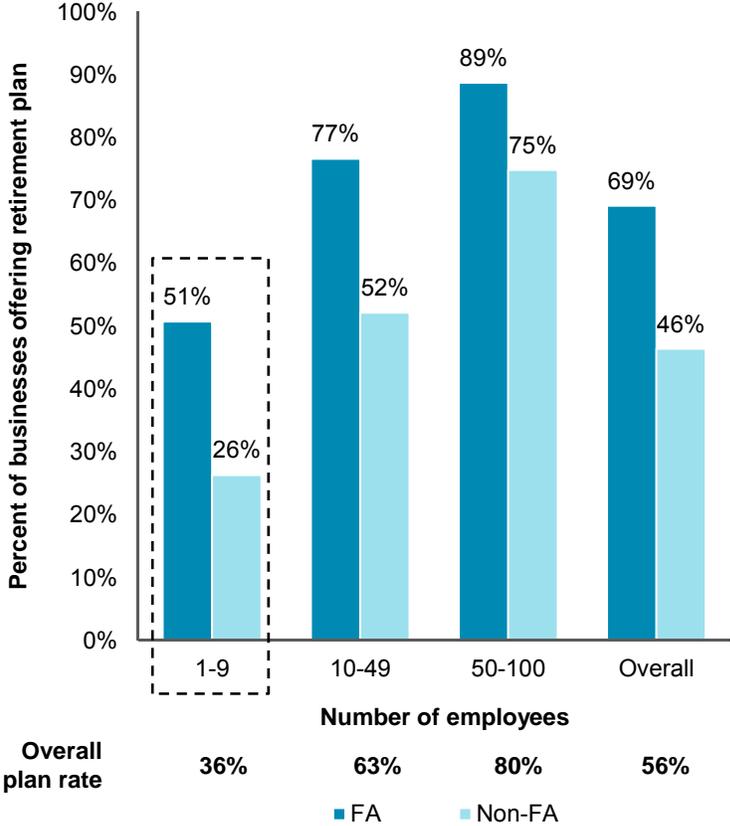


²⁰ Oliver Wyman Small Business Retirement Survey 2014, Respondents were asked to allocate 100 points across all their advisors in terms of their contribution to the business setting up a workplace retirement plan; presented values are calculated as the average score per advisor type.

Small businesses with financial advisors are 50% more likely to set up a retirement plan overall and micro businesses with financial advisors are nearly twice as likely to set up a plan

We found that 41% of small businesses with 100 or fewer employees work with a financial advisor, and that these firms are significantly more likely to set up a retirement plan. Specifically, businesses with 1–9 employees with a financial advisor are almost twice as likely to set up a retirement plan as are businesses without financial advisors (51% vs. 26%). Businesses with 10–49 employees with a financial advisor are 48% more likely (77% vs. 52%) and businesses between 50 and 100 employees are 19% more likely (89% vs. 75%) to set up a plan. These differences are illustrated in Figure 7 below. Additionally, micro businesses (1-9 employees) with financial advisors are 18% more likely to offer employer matching with a financial advisor (85%) than without (72%).

Figure 7: Plan formation rates by size of firm and advisor status²¹

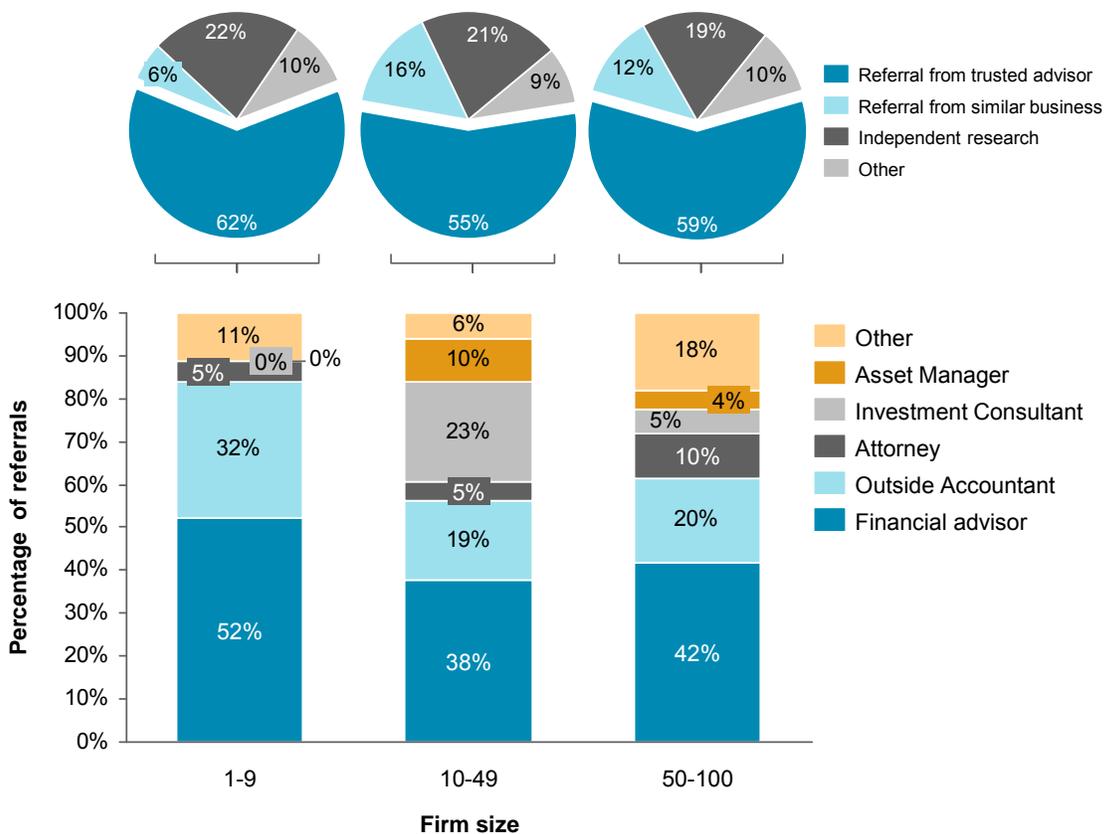


²¹ Oliver Wyman Small Business Retirement Survey 2014

Financial advisors play a key role in referring small businesses to service providers, such as plan administrators/ recordkeepers and fiduciary service providers

As Figure 8 shows, a majority of small businesses, ranging from 55%–62% depending on size, found their workplace retirement plan provider via a referral from a trusted advisor. Financial advisors and accountants were the most common referral sources on a relative basis, with financial advisors cited between 33–45% of the time²², depending on company size.

Figure 8: Frequency of referral to service provider(s), by advisor²³



²² Raw results are normalized to account for relative frequencies of different advisors. For example, in the 1-9 business segment, financial advisors provide 41% of all referrals on an unadjusted basis. We weighted this figure by the prevalence of financial advisor relationships among these businesses (i.e. 38%) and re-scaled all advisor scores to total 100%. This approach yields relative referral rates by removing skews associated with advisor prevalence.

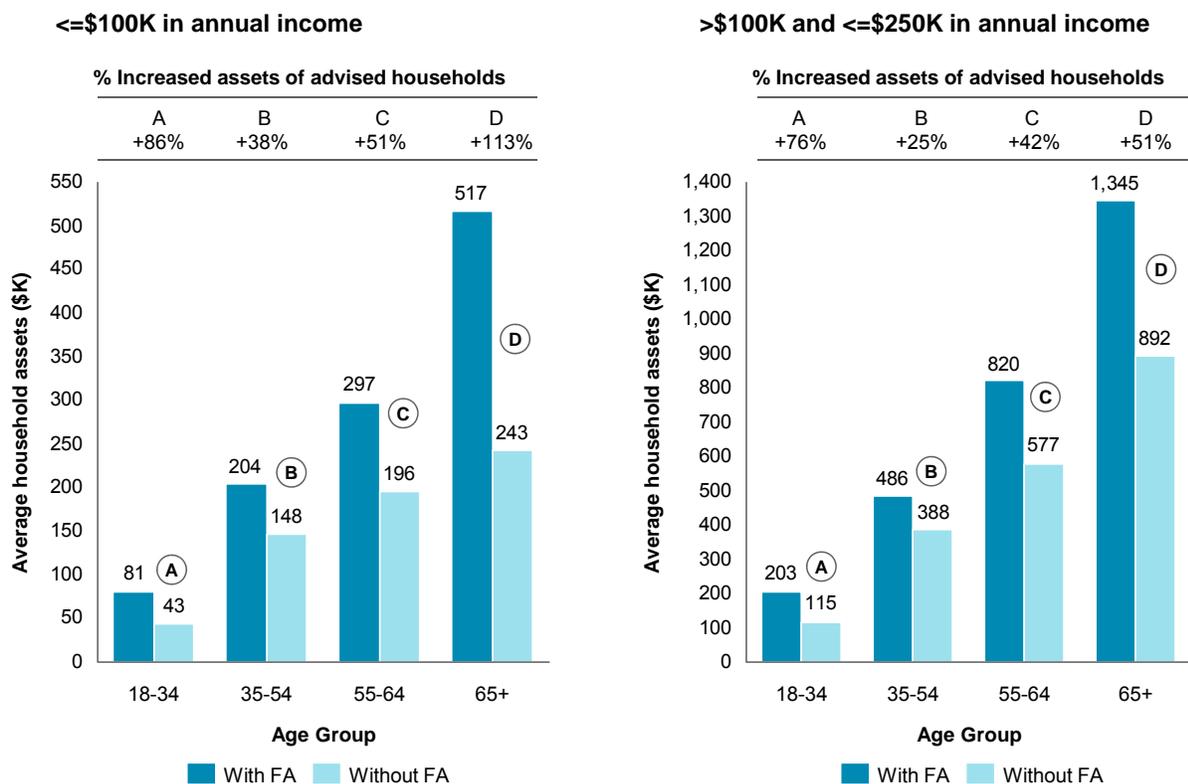
²³ Oliver Wyman Small Business Retirement Survey 2014

II. Role of financial advisors in helping individuals save for retirement

In our Retail Investor Retirement Survey, advised investors had a minimum of 25% more assets than non-advised individuals, depending on age and income levels

A key finding of our research is that individuals with a financial advisor have more assets than non-advised individuals across age, income, and wealth segments, as shown in Figure 9.

Figure 9: Total asset levels across relationship status, age, and income²⁴



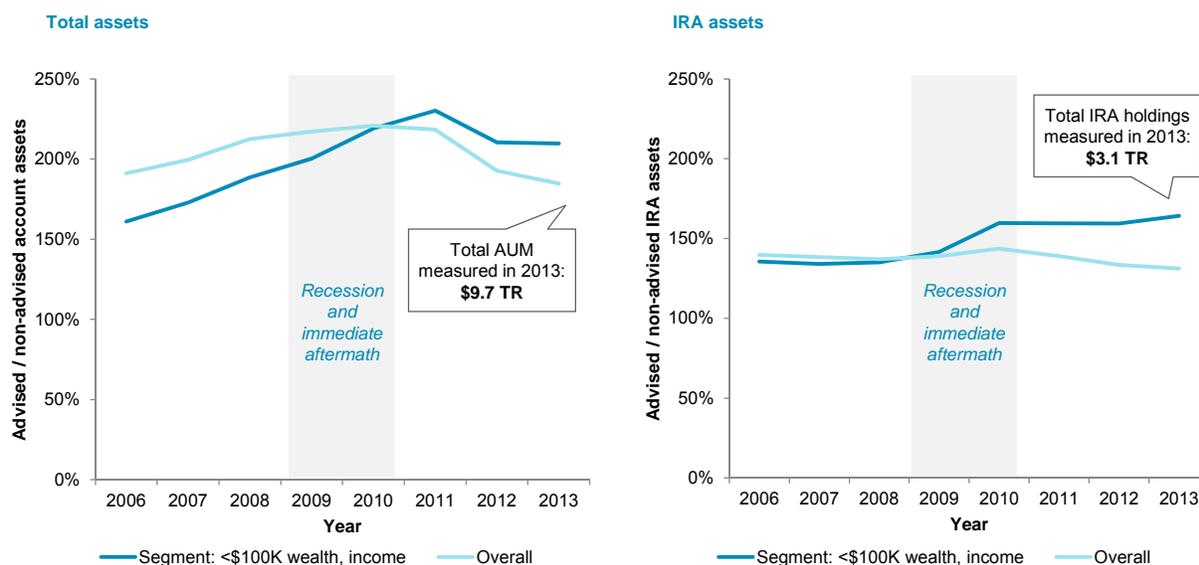
This finding holds true even when excluding survey respondents who anticipate receiving retirement income from either an inheritance or trust fund.

²⁴ Oliver Wyman Retail Investor Retirement Survey 2014

Our analysis of the IXI data, representing ~20% of U.S consumer invested assets, further substantiates and expands on this finding. We found that individuals with a financial advisor have larger account balances (including IRA assets) across age, income and wealth levels. Specifically, in 2013, 98% of accounts examined for advised individuals reflected $\geq 10\%$ more investment assets compared to those of non-advised individuals controlling for age, wealth, and income. Moreover, 90% of accounts reflected $\geq 25\%$ more investment assets among advised accounts.

This finding holds true across multiple time periods for specific wealth and income cohorts. Figure 10 illustrates this point for all segments as well as the segment with annual income and wealth below \$100,000.

Figure 10: Ratio of average asset holdings for advised and non-advised investors²⁵



As described in detail below, our research finds that individuals with a financial advisor are better investors across many dimensions commonly associated with long term investing success.

Advised individuals are better long term investors

Key elements of a robust long-term investing program typically include:

- A. Developing and maintaining a personalized financial plan

²⁵ IXI account-level time series dataset of U.S. Consumer Invested Assets; Oliver Wyman Analysis

- B. Commitment to regular saving and investment
- C. Constructing and maintaining a well-diversified portfolio of appropriate investment products
- D. Staying invested in the market
- E. Periodically re-balancing investment holdings to restore desired asset allocation and risk levels

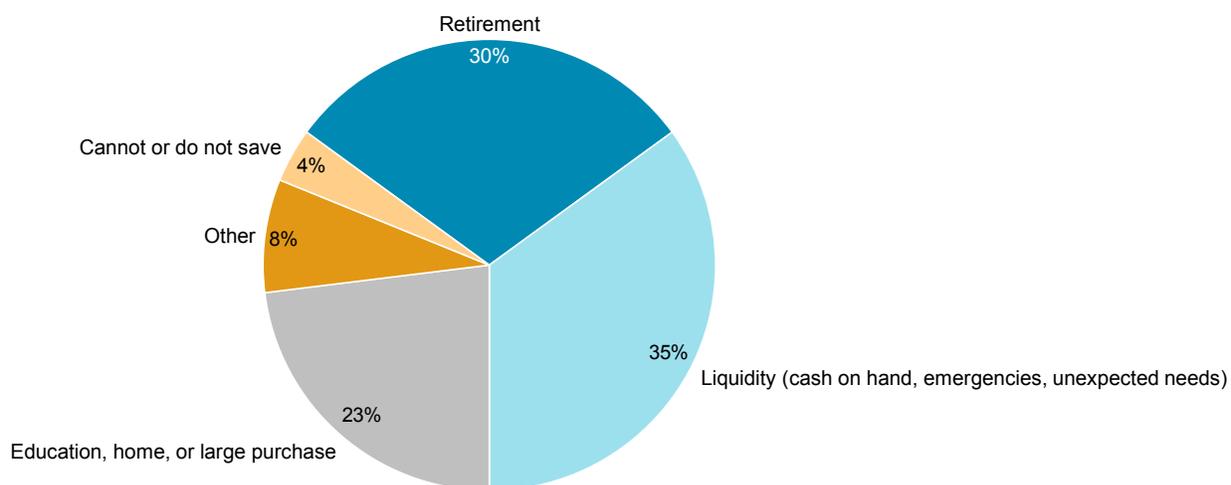
We found that financial advisors play an important role in helping individuals adopt each of these investing practices commonly associated with better investing outcomes.

A. Developing and maintaining a personalized financial plan

Individual investors' savings goals include liquidity, education and retirement, but their primary focus varies with life stage

Individuals have a range of different investment goals. As indicated in Figure 11, investors' most common investing objectives are ensuring sufficient liquidity; saving for retirement; and funding education or a large purchase, such as a home.

Figure 11: Households' primary reasons for saving²⁶



The primary reasons for saving often vary significantly with life stage, however. In a recent survey, the Investment Company Institute (ICI) found that Households with a head of household younger than 35 primarily save for liquidity purposes (39%), whereas

²⁶ Investment Company Institute, The Success of the U.S. Retirement System, Figure 1 (http://www.ici.org/pdf/ppr_12_success_retirement.pdf)

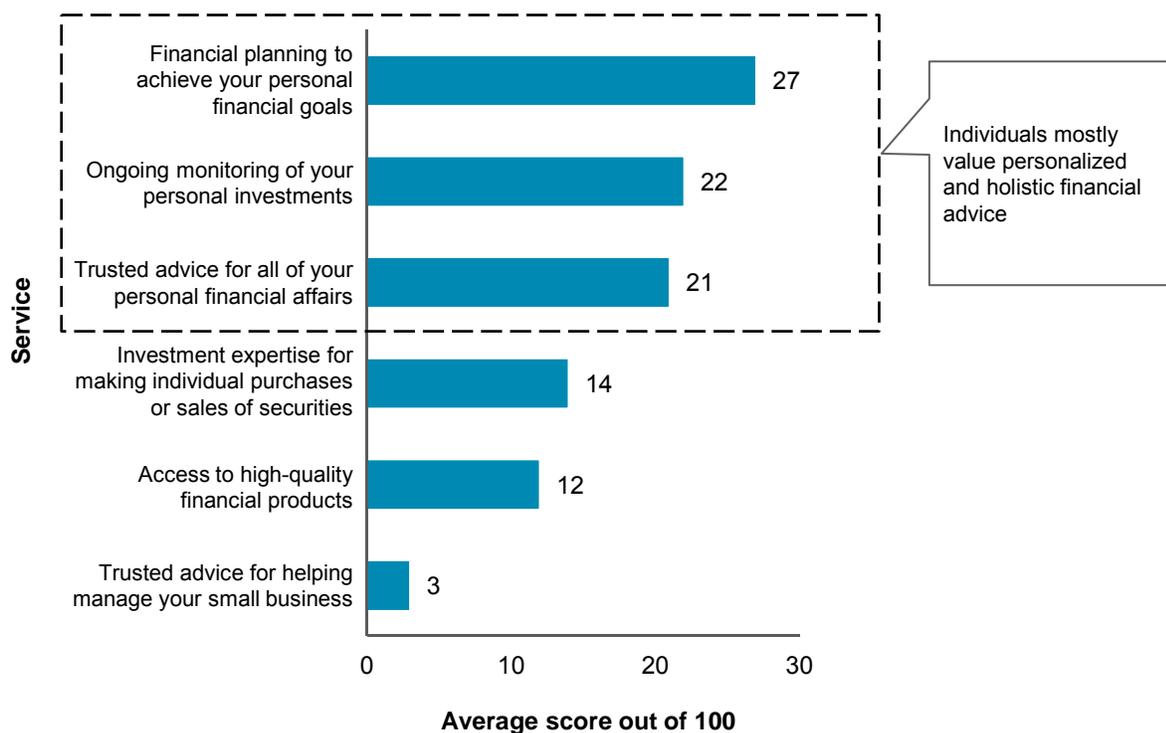
those in which the head of household is between 50 and 64 years old, are focused on retirement savings (48%).

58-75% of non-retired households seek professional financial advice, depending on wealth, and most value personalized financial planning, investment monitoring and holistic advice

Many Americans are uncomfortable with investing on their own, and consult with a financial advisor to assist with achieving their goals. By one measure, 58% of households with under \$100,000 in investable assets, and 75% of non-retired households with over \$100,000 in investable assets, solicit professional financial advice²⁷.

In our research, individuals most value the following services from their financial advisor: personalized financial planning, ongoing monitoring of investments and trusted advice for all their personal financial affairs (Figure 12).

Figure 12: Financial advisor services valued by investors²⁸



²⁷ 2013 Survey of Consumer Finances

²⁸ Oliver Wyman Retail Investor Retirement Survey 2014

Against investor demand for holistic advice, we observe different help and support models available within workplace retirement plans and outside plans. In-plan help and advice is often well suited for individuals whose workplace plan represents their primary investment savings, while outside plan advice is a better fit for individuals with multiple investment accounts seeking advice and guidance on all investment holdings.

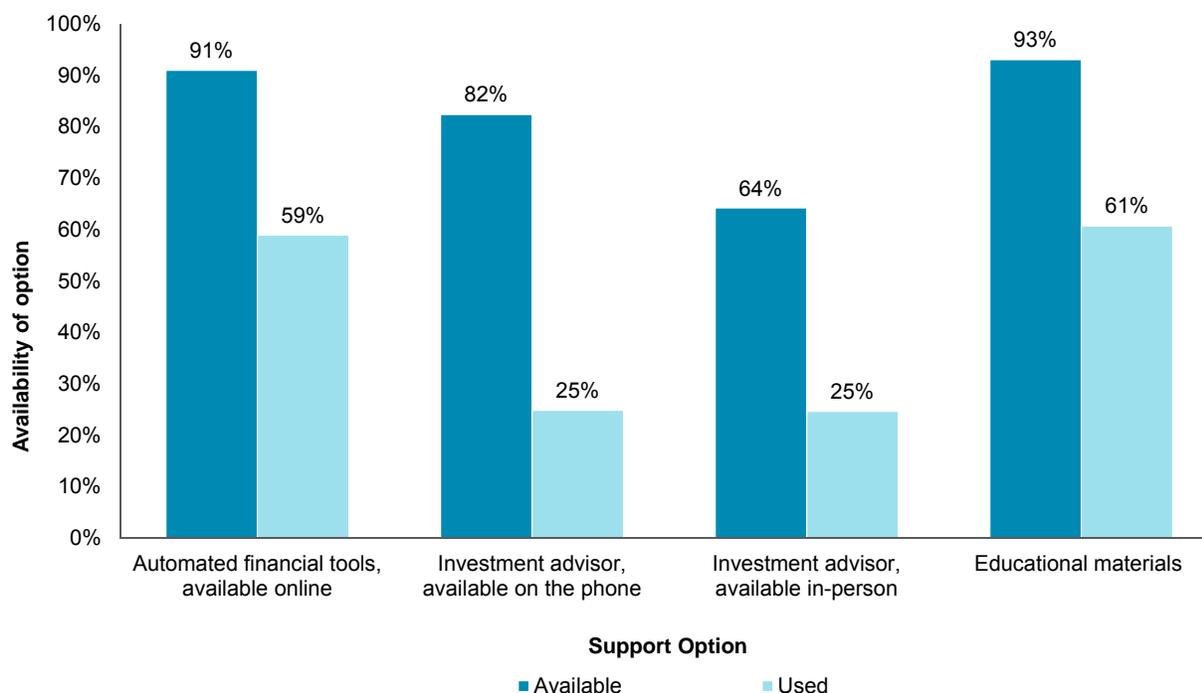
The majority of DC plans now offer a variety of educational materials, tools and advice options to enable individuals to make informed investment decisions. Educational materials and automated financial tools are the most widely available as well as the most used features as shown in Figure 13. In our research, in-plan advice had a positive impact on participant behavior for those who used it. We found participants who made use of at least one type of support contributed an average of 2.0 percentage points²⁹ more of their salary to a DC plan (6.7% vs. 4.7%) – an increase of 43%. When done in younger working years, this difference could mean a substantial difference in asset accumulation at retirement.

Participants who use in-plan advice features save 43% more, on average

We also found that fewer than half of plan participants currently use in-plan advice features. While 82% of individuals have access to an investment advisor on the phone and 64% have the ability to meet with a financial advisor in-person, utilization of these services is low. Of the individuals that participated in our survey, just 25% consulted with an advisor on the phone and 25% met with a financial advisor in-person.

²⁹ Oliver Wyman Retail Investor Retirement Survey 2014

Figure 13: Availability and usage of in-plan support options (for respondents with a defined contribution plan)



In-plan advice models are often more limited in scope compared with external advisory offerings

A number of financial firms operating in a brokerage model have forged partnerships with in-plan advice providers such as Financial Engines, Morningstar and Wilshire Associates, instead of establishing a relationship with their financial advisory businesses, to provide basic help and advice to plan participants on current plan holdings and investment options.^{30,31,32} Due to legal constraints, this form of advice is generally limited to plan assets, which does not meet the full needs of individuals that hold assets in multiple DC plans and other brokerage and/or advisory accounts.

³⁰ Financial Engines, 2012 Annual Report (<http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MTc3OTk4fENoaWxkSUQ9LTF8VHlwZT0z&t=1>)

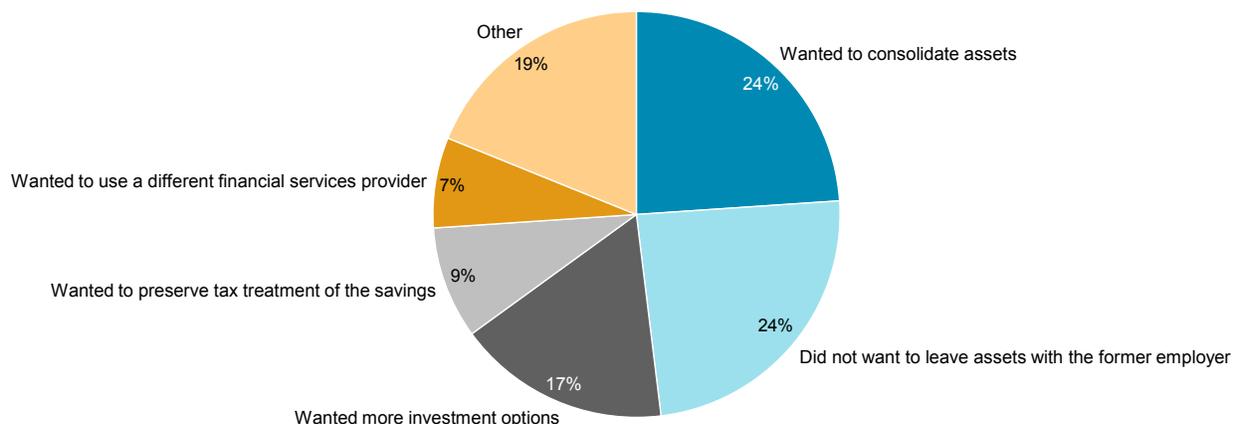
³¹ Morningstar, 2012 Annual Report, (<http://corporate.morningstar.com/us/documents/PR/2012-Morningstar-Annual-Report.pdf>)

³² Wilshire Associates, Retirement Managed Accounts, (<http://www.wilshire.com/funds-management/our-solutions/retirement-managed-accounts>)

Individuals elect IRA rollovers for many reasons including asset consolidation, increased investment options and access to a different financial services provider

Many individuals prefer to access financial help and support outside of their DC plans and choose to rollover their DC plan assets to an IRA when changing employers. According to a 2014 ICI report, “The Role of IRAs in US Household Saving for Retirement”, more than 41 million US households hold an IRA of some type. In addition, as shown in Figure 14, ICI further found that nearly half of all rollover decisions were motivated by a desire to consolidate assets and avoid leaving assets with the former employer.

Figure 14: Primary reason for most recent rollover among those choosing to roll over assets³³



Only 29% of workplace plan participants use DC plans exclusively for retirement savings; nearly two-thirds use a combination of DC plans and IRAs or IRAs only³⁴

As demonstrated by the distribution of retirement plans within our sample of investors (Figure 15), 44% of individuals utilize both DC plans and IRAs in order to take advantage of the benefits of each type of account. As noted previously, IRAs offer

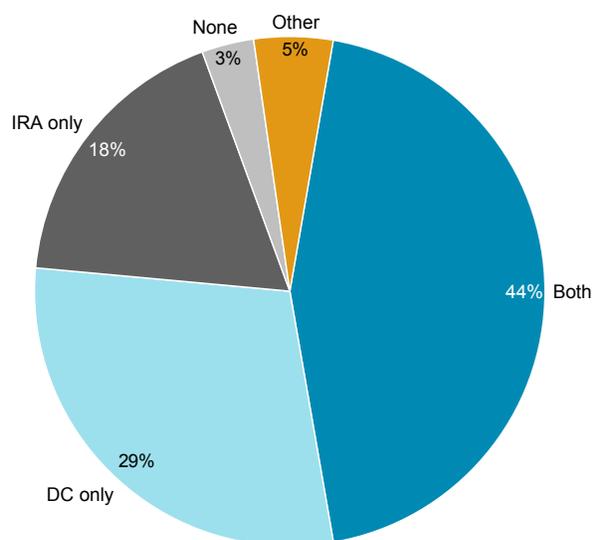
³³ Investment Company Institute, The Role of IRAs in U.S. Households' Saving for Retirement, 2014 (<http://www.ici.org/pdf/per21-01.pdf>)

Other includes 'Were told by a financial advisor to roll over assets', 'Wanted to keep assets with the same provider', 'Thought it was easier to roll over assets to an IRA', and 'Wanted the same investments as former employer's plan'.

³⁴ Oliver Wyman Retail Investor Retirement Survey 2014

access to holistic help and support, a wider selection of financial products, and greater control. In comparison, DC plans have a higher limit for tax-deferred annual savings (e.g. \$18,000 for 401(k)s vs. \$5,500 for IRAs, excluding catch up contributions) and employer matching contributions (where available), making them attractive vehicles for new retirement contributions.

Figure 15: Retirement plan ownership among investors³⁵



B. Commitment to regular saving and investment

Individuals with a financial advisor are more likely to own an IRA, have greater IRA assets and save more of their income in 401(k) plans

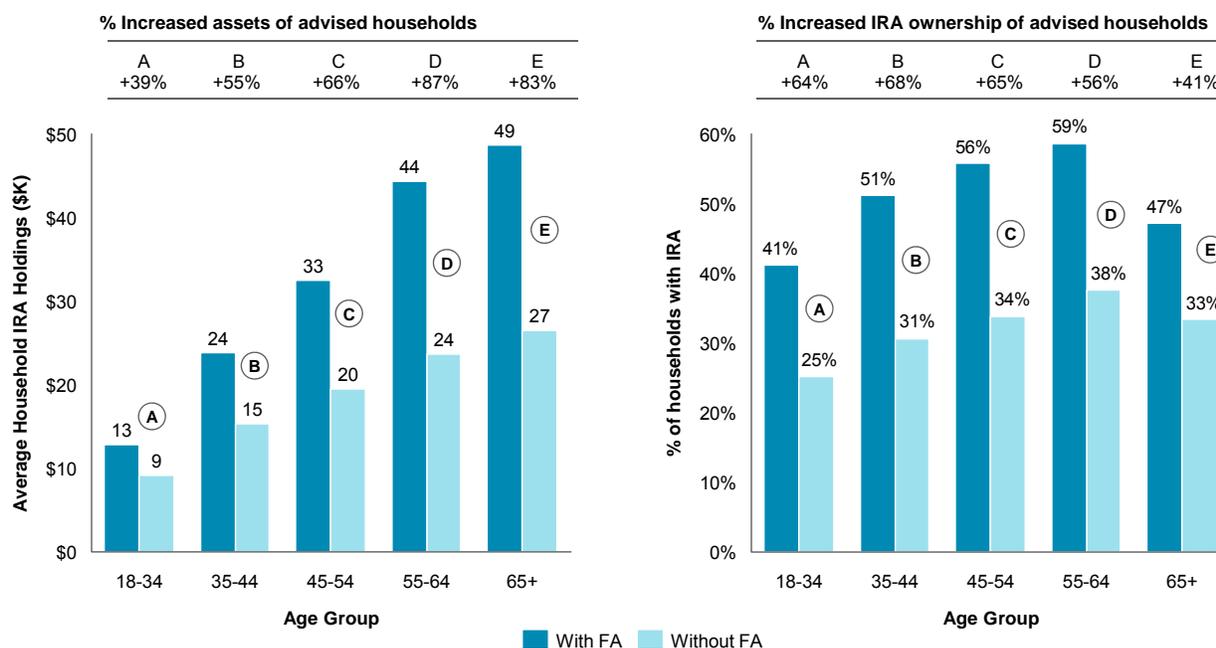
Individuals with a financial advisor are more likely to have an IRA. In 2013, 99.8% of households examined belonged to an age / income / wealth segment in which advised households were $\geq 10\%$ more likely to have an IRA compared to non-advised households (and 87% of households belonged to segments in which advised households were $\geq 25\%$ more likely to have an IRA).

Additionally, 94% of households examined belonged to an age / income / wealth segment in which advised households held $\geq 25\%$ more IRA assets compared to non-advised households. Our findings for IRA ownership and asset levels hold true across income, age, and wealth segments. For example, Figure 16 shows IRA ownership and

³⁵ Oliver Wyman Retail Investor Retirement Survey 2014, includes only those with retirement or investment accounts

assets for advised and non-advised households within different age groups for the cohort with \$0-100K in annual income and wealth, respectively. In this cohort, increased IRA ownership ranges from 41% higher for households with accounts registered to individuals 65 and older to 68% higher for those in the 35-44 age group. IRA asset levels for the \$0-100K annual income and wealth cohort ranges from 39% higher for households with accounts registered to individuals aged 18-34 to 87% more for those aged 55-64.

Figure 16: IRA ownership and assets (2013) – Income: \$0-100K, Wealth: \$0-100K³⁶



These results are consistent with a recent Natixis survey, where individuals with a financial advisor were found to hold more assets in their 401(k) across age and income segments, compared with non-advised investors. The Natixis survey also found that individuals with a financial advisor contributed an average of 1-2% more of their pre-tax salary to their 401(k) across age and income segments.³⁷

³⁶ IXI household-level dataset of U.S. Consumer Invested Assets; Oliver Wyman Analysis

³⁷ Saving is Not Enough: Liabilities, shortfalls and the need for active participation in 401(k) plans; Natixis Global Asset Management, August 2014 – online survey of 899 participants (427 with FA, 472 without FA) across age and groups

C. Constructing and maintaining a well-diversified portfolio of appropriate investment products

The benefits of portfolio diversification are well documented. Figure 17 shows how a diversified balanced index outperformed the S&P 500 by an average of 1.7 percentage points annually (11.2% vs. 9.5%) over a long time period (1965-2012) spanning multiple business cycles.

Figure 17: Comparison of return by portfolio composition³⁸

Portfolio Mix	1965-1981	1982-1999	2000-9/2012	Total Period
S&P 500 Index	+6.3%	+18.5%	+1.7%	+9.5%
Cash	+6.7%	+6.2%	+2.2%	+5.3%
Diversified Balanced Index	+9.9%	+15.1%	+7.4%	+11.2%

Individuals with a financial advisor exhibit more diversified investment portfolios compared to non-advised individuals across a number of dimensions

Portfolio diversification refers to the practice of mitigating investment risk by investing in a variety of un-correlated products. There are a number of ways to assess portfolio diversification. We have attempted to assess relative portfolio diversification between advised and non-advised individuals with respect to several basic measures.

1. **The number of asset classes within the portfolio** – The correlation between investments in different asset classes is typically lower than that between investments in the same asset class. Thus, the more distinct asset classes in an investor’s portfolio the more diversified the portfolio, on average.
2. **The ratio of equities to fixed income** – This is a basic measure of portfolio risk with a higher concentration in equities typically signaling a riskier portfolio. A “60/40” portfolio consisting of 60% equity and 40% fixed income is widely recognized as a balanced portfolio that provides capital appreciation and income while limiting volatility and potential loss of capital. A substantial overweighting of

³⁸ DFA Returns 2.0

equities or fixed income could indicate a misalignment between intended and actual risk-taking.

- 3. The use of packaged products vs. individual securities** – Packaged products like mutual funds are typically composed of many securities, and have lower non-systematic risk (i.e. individual company risk exposure) than an equivalent investment in a smaller number of individual securities. As a result, investment strategies employing packaged products tend to be more diversified than strategies that rely only on individual securities.

Based on each of these three measures of diversification, we found individuals with a financial advisor have more diversified portfolios than individuals without a financial advisor.

1. Number of asset classes within the portfolio – Individuals with a financial advisor own twice as many asset classes as non-advised individuals

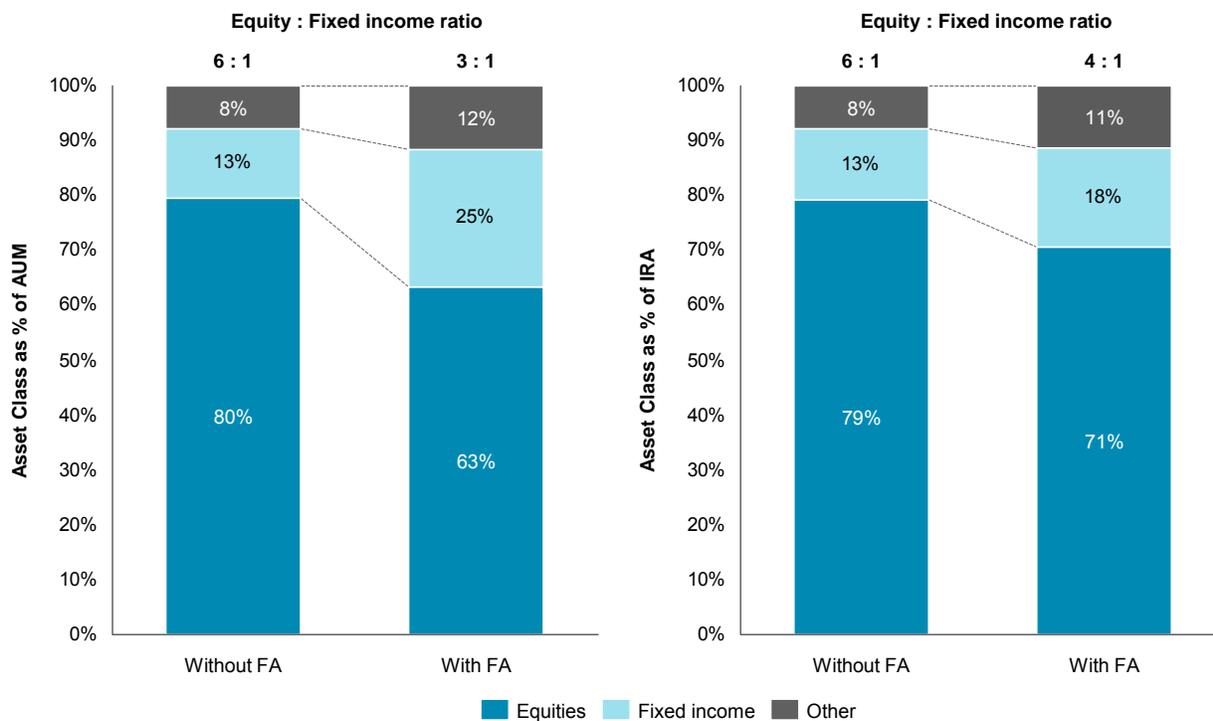
In a 2010 study, Charles Schwab found that financial advisors help clients achieve greater investment diversification, and that the average investor receiving professional advice invests in over four more asset classes than an investor who does not (e.g. more than 8 versus 3.7)³⁹.

2. Ratio of equities to fixed income -- Advised individuals have more balanced portfolios than non-advised investors, and hold, on average, more than 20% less equities and nearly twice as much fixed income

Individuals with a financial advisor have more balanced portfolios with less equity exposure and higher fixed income allocations than non-advised individuals. As shown in Figure 18, advised individuals held 17 percentage points (more than 20%) less equity than non-advised individuals, as well as nearly twice as much fixed income exposure (25% vs. 13% as a percent of the total portfolio). IRA holdings show a similar finding where the difference in equity exposure is 8 percentage points (or 10%) less of an allocation for advised individuals vs. those without a financial advisor. By contrast, fixed income exposure is 38% higher for advised vs. non-advised individuals.

³⁹ Charles Schwab, 'Advice Matters: New Charles Schwab Study Demonstrates Positive Impact of Professional Advice on 401(k) Investor Behavior', (<http://pressroom.aboutschwab.com/press-release/schwab-corporate-retirement-services-news/advice-matters-new-charles-schwab-study-demo>)

Figure 18: Assets and IRA asset class mix for households with and without a financial advisor⁴⁰

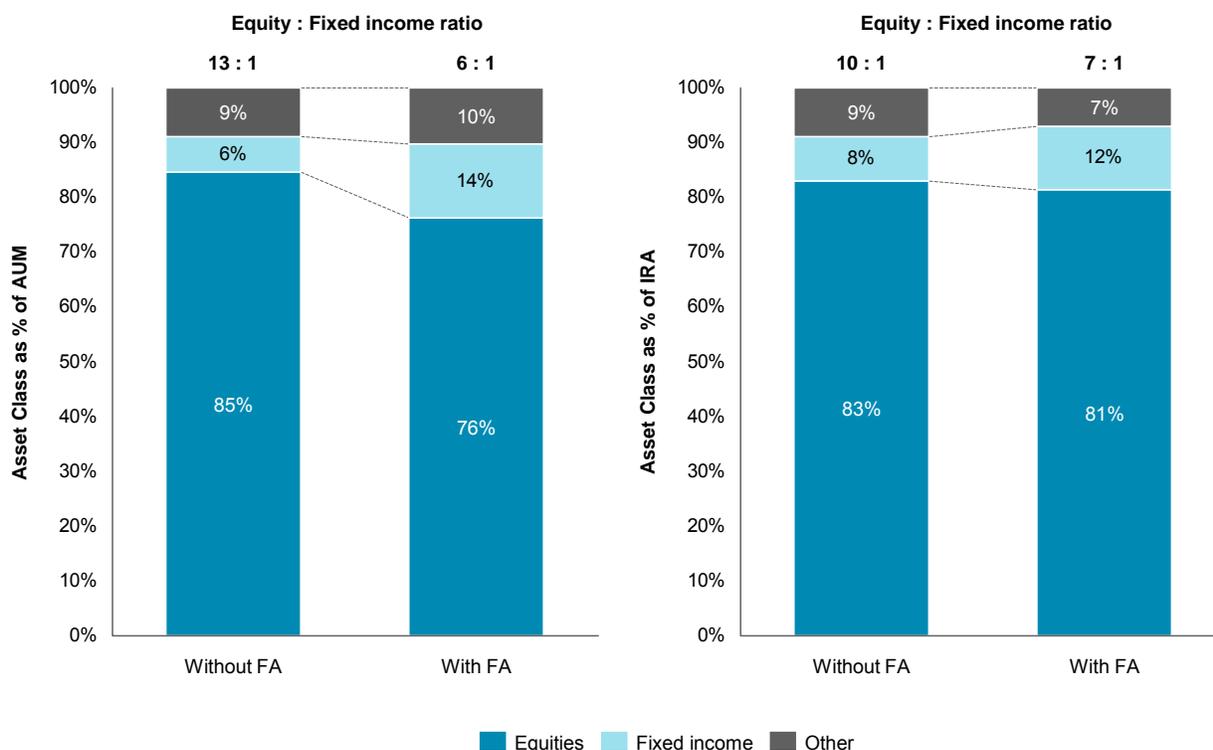


The finding of more balanced portfolios among advised individuals persists when controlling for age, income, and wealth, as 72% of households belong to a segment in which advised households hold more than 20% less of their assets in equities⁴¹. By way of further example, Figure 19 shows the same analysis of the segment aged 45-54 with less than \$100,000 in annual income and total wealth, respectively. In this case, the difference in equity exposure is 76% vs. 85% of total assets for advised vs. non-advised individuals. Additionally, advised individuals hold more than twice as much fixed income as a percent of total assets, and 1.5 times as much in IRAs.

⁴⁰ IXI household-level dataset of U.S. Consumer Invested Assets; Oliver Wyman Analysis; percentages may not add up to 100% due to rounding

⁴¹ Measured as a percentage of the total portfolio assets

Figure 19: Assets and IRA asset class mix – Age: 45-54, Income: \$0-100K, Wealth: \$0-100K⁴²

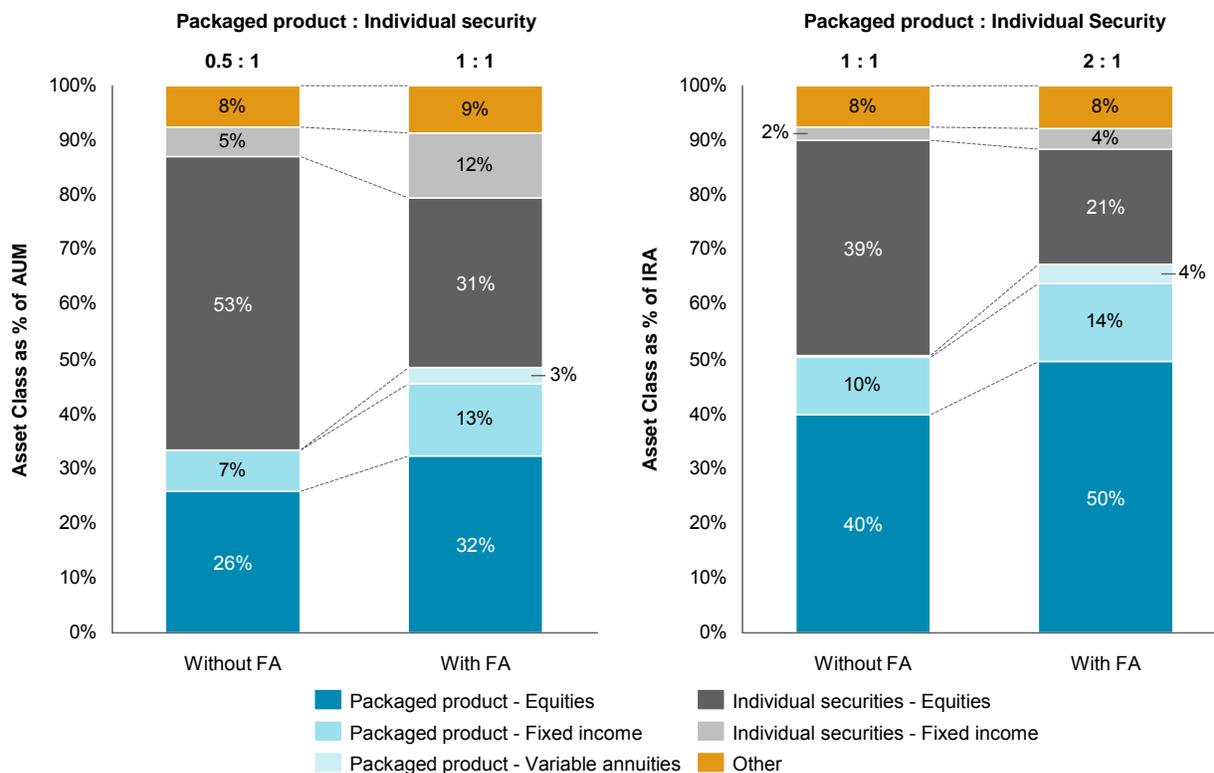


3. Use of packaged products vs. individual securities – Non-advised individuals hold 70% more of their equities exposure in individual securities compared to advised individuals

Finally, individuals with a financial advisor hold more of their equity exposure in packaged products compared to individuals without a financial advisor. Figure 20 shows individuals with a financial advisor hold approximately equal proportions of their equity exposure in packaged products and individual securities. By contrast, investors without a financial advisor hold 1.7 times as much of their equity exposure in individual securities, on average. The mix of IRA holdings again reflects this trend.

⁴² IXI household-level dataset of U.S. Consumer Invested Assets; Oliver Wyman Analysis

Figure 20: Assets and IRA product mix for households with and without a financial advisor⁴³

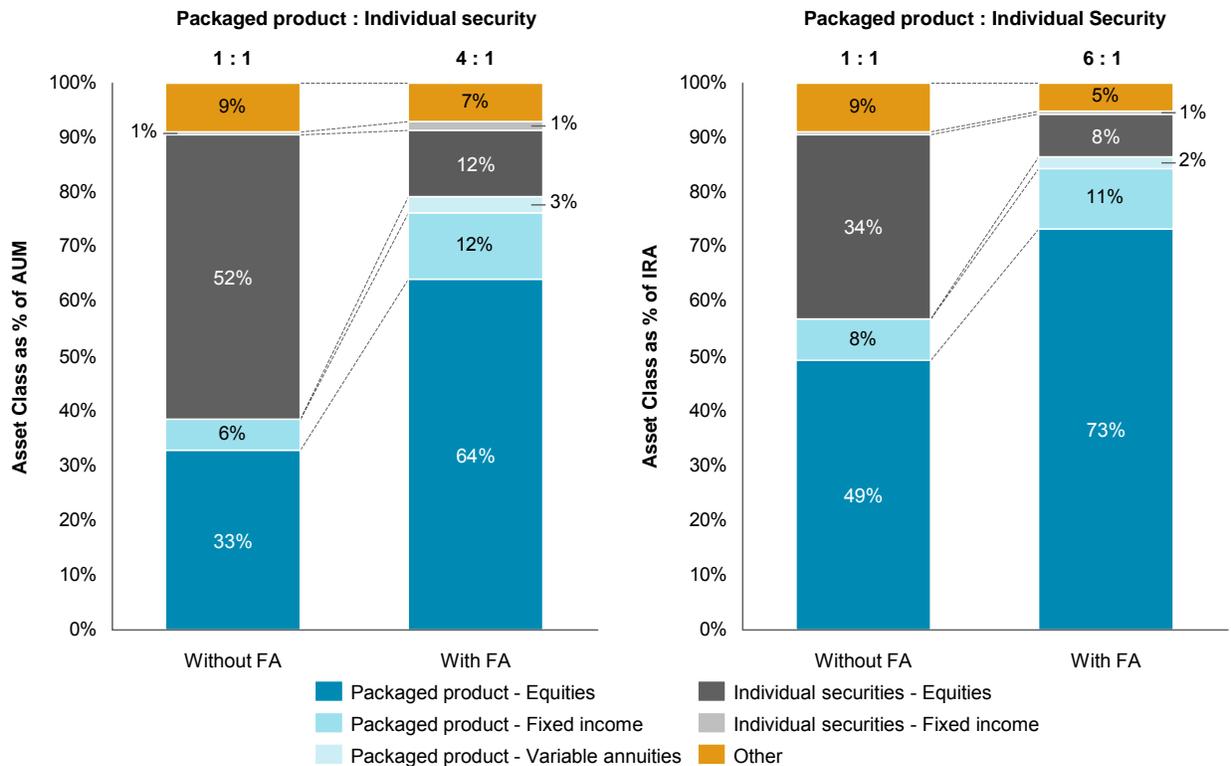


These trends hold true when controlling for age, income, and wealth. Figure 21 shows the findings for one particular segment (i.e. the cohort aged 45-54 with less than \$100,000 in annual income and total wealth, respectively), where the comparison is even more stark. In this case, non-advised individuals hold more than four times as much of their portfolios in individual equity securities vs. equity packaged products.

In the cohort aged 45-54 with less than \$100,000 in annual income and wealth, non-advised individuals hold four times more equity exposure through individual securities compared with advised investors

⁴³ IXI household-level dataset of U.S. Consumer Invested Assets; Oliver Wyman Analysis; percentages may not add up to 100% due to rounding of values

Figure 21: Assets and IRA product mix – Age: 45-54, Income: \$0-100K, Wealth: \$0-100K⁴⁴



D. Staying invested in the market

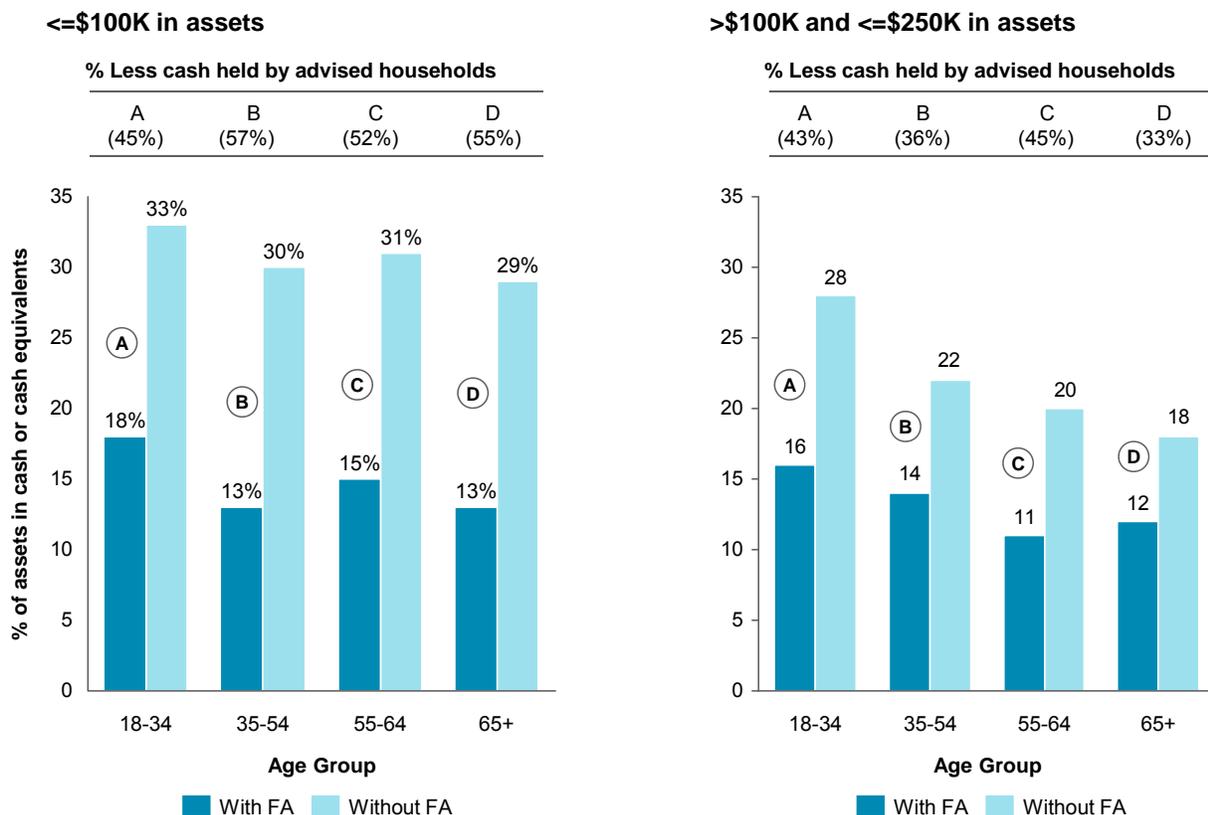
Individuals with a financial advisor hold smaller cash balances – ranging from 36%-57% less than non-advised individuals for similar age and wealth cohorts

In our Retail Investor Retirement Survey, we found that individuals with financial advisors hold a smaller percentage of their non-retirement assets in cash equivalents. As shown below in Figure 22, this finding holds true across all asset and age strata⁴⁵. As cash equivalent holdings have lower real returns, individuals may potentially achieve higher long-term returns by limiting their allocation to cash.

⁴⁴ IXI household-level dataset of U.S. Consumer Invested Assets; Oliver Wyman Analysis; percentages may not add up to 100% due to rounding of values

⁴⁵ The differences observed in cash holdings between advised and non-advised households was significant at a 95% confidence level for all segments except the group aged 65 or older with \$250K-\$ 1MM in assets

Figure 22: Percent of assets held in cash or cash equivalents outside of workplace retirement plans⁴⁶



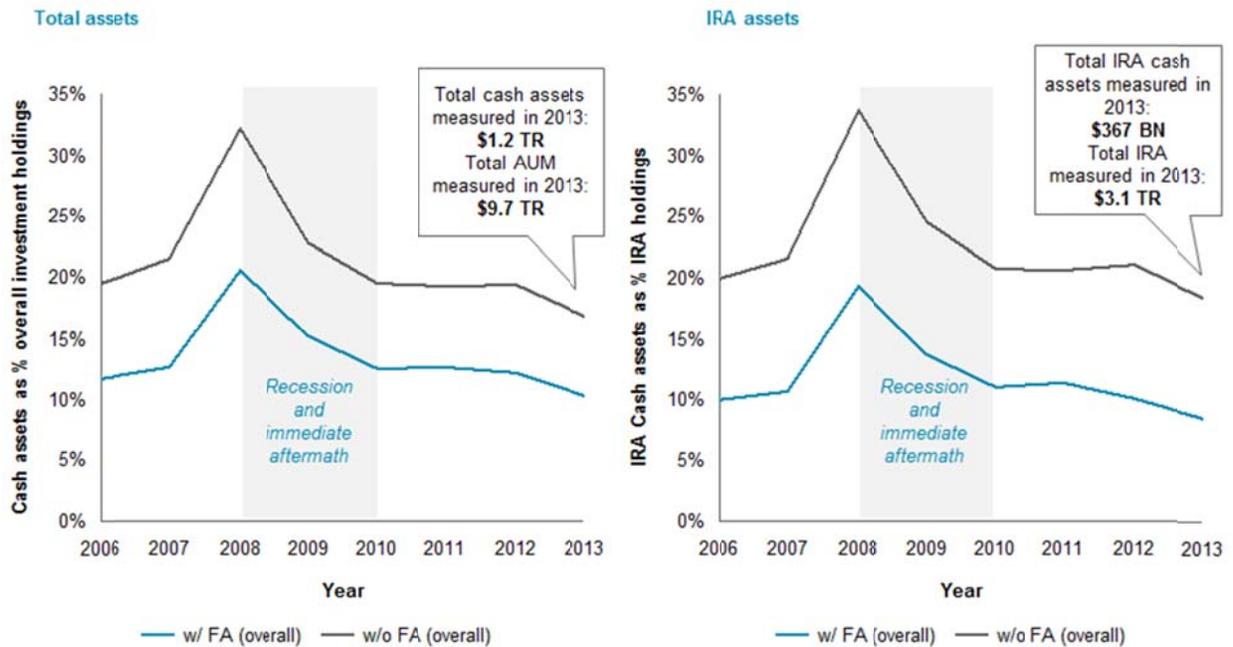
Again, the IXI data supports and expands upon this finding, which holds true over time for both total assets as well as retirement assets in IRA accounts across income, wealth, and age segments analyzed. For example in 2013, nearly 99% of advised households held 25% or more less cash and/or cash equivalents as a percentage of their portfolio compared to non-advised.⁴⁷

Figure 23 depicts this trend for the overall population analyzed.

⁴⁶ Oliver Wyman Retail Investor Retirement Survey

⁴⁷ IXI account-level time series dataset of U.S. Consumer Invested Assets; Oliver Wyman Analysis

Figure 23: Cash holdings as a percent of account assets for advised and non-advised investors⁴⁸



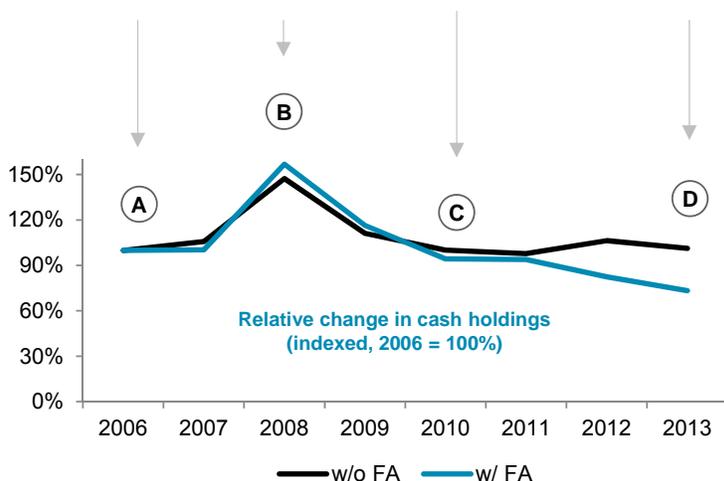
Analysis of the segment with less than \$100K in wealth and income similarly shows that advised investors held substantially less cash as a portion of total account assets before (48% less), during (44% less) and after the financial crisis (60% by the end of 2013). (Figure 24).

⁴⁸ IXI account-level time series dataset of U.S. Consumer Invested Assets; Oliver Wyman Analysis

Figure 24: Cash holdings as a percent of total account assets for investors with and without a financial advisor – Segment with <\$100K in wealth and income⁴⁹

Average cash holdings (% of account assets)

	Pre crisis	Peak crisis	Post crisis+2	Post crisis+5
w/o FA	23%	34%	23%	23%
w/ FA	12%	19%	12%	9%



- A** Pre-financial crisis investors without a financial advisor held nearly 2X as much cash as advised investors
- B** Both types of investors increased cash holdings during the crisis
Even after accounting for a sharp drop in equity market values, investors increased cash holdings¹
- C** By 2010, cash allocations for both types of investors had returned to pre-crisis levels
However, investors with a financial advisor held nearly 50% less cash as a percent of total investable assets
- D** At the end of 2013, advised investors held 25% less cash vs. pre-crisis levels, while allocations investors without an FA remained constant
At year-end 2013, non-advised investors held more than 2.5 times as much of their portfolios in cash

¹ Cash allocations could have increased without any change in investor behavior due to the large decline in equity markets. We analyzed the magnitude of this potential effect in the following manner. Average advised investor pre-crisis (2007) allocation to equities was 60% while cash holdings represented 12% of investable assets. Assuming (1) no change in portfolio holdings, (2) only equity values changed, and (3) the equities allocation performed similarly to the S&P (as measured by SPY) during the financial crisis, the 38% drop in SPY share price in 2008 could have represented at most 3.5% of the 7% point increase cash holdings, i.e. $.12/(1-(0.38*0.6))-.12$. The equivalent figure for non-advised is 8%, i.e. $0.24/(1-(0.38*0.66))-0.24$ of the 10% point increase in cash holdings. Since actual equity allocations dropped by only 40-45% of that predicted in (3) above, the equity market decline is estimated to account for an even smaller portion of increased account cash allocations.

The finding of persistently lower cash allocations for advised investors provides strong evidence that financial advisors help individuals enter and stay invested in the market across market cycles leading, on average and over time, to better investing outcomes.

Excess cash holdings represent a drag on investment performance. However, premature withdrawal of retirement account assets is an even costlier investing behavior that reduces principal and the potential benefit of compounded returns.

⁴⁹ IXI account-level time series dataset of U.S; Morningstar, Oliver Wyman Analysis

Financial advisors help individuals avoid premature IRA distributions - 76% of heads of households that made traditional IRA withdrawals in 2013 were retired

Tax-advantaged workplace retirement plans provide the greatest benefit when individuals start saving early and continue to save and invest throughout their working years until retirement age. According to a GAO study, “Cashouts [have] the greatest ultimate impact on participants’ retirement preparedness [...] Cashouts of 401(k) accounts at job separation can result in the largest amounts of leakage and the greatest proportional loss in retirement savings.”⁵⁰

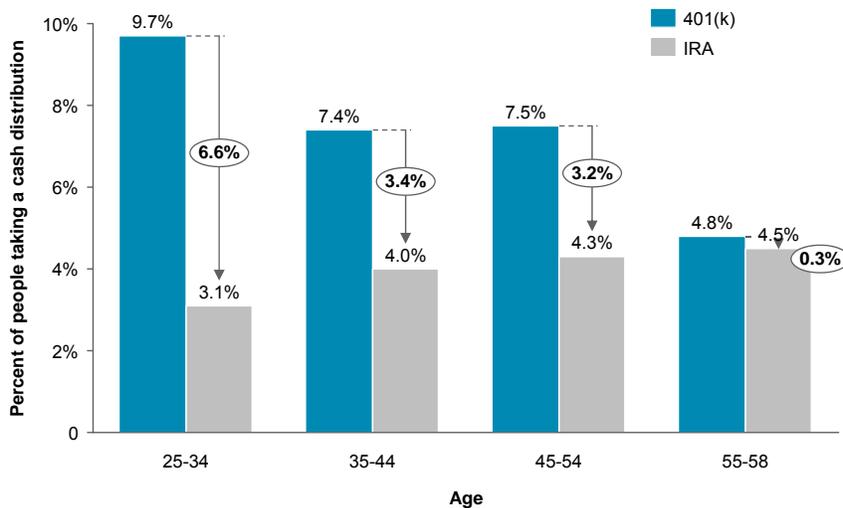
Approximately 9 out of 10 (88%) IRA accounts are held in a brokerage model, where an individual has access to a range of different types of advice and support from a financial advisor.⁵¹ According to ICI, IRA holders tend to keep assets in their accounts until retirement. In 2013, 76% of households that made traditional IRA withdrawals were retired. This stands in contrast with DC plan behavior, where there is a natural triggering event when individuals terminate employment. According to a Vanguard study, 38% of individuals in their twenties took cash distributions upon leaving their employer⁵². Moreover, individuals aged 25-34 were more than three times as likely to take a cash distribution from a 401(k) compared to an IRA when leaving a job. Different distribution rates by age cohort and account type are illustrated in Figure 25.

⁵⁰ Government Accountability Office, ‘401(k) Plans: Policy Changes Could Reduce the Long-term Effects of Leakage on Workers’ Retirement Savings’, August 2009

⁵¹ Oliver Wyman, ‘Assessment of the Impact of the Department of Labor’s Proposed “Fiduciary” Definition Rule on IRA Consumers’, 2011

⁵² Vanguard, ‘How America Saves 2013: A report on Vanguard 2012 defined contribution plan data’, June 2013

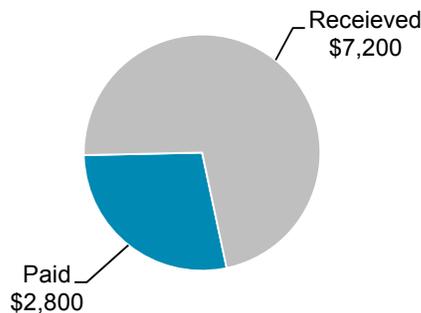
Figure 25: Percentage of individuals taking cash distributions by age and plan type⁵³



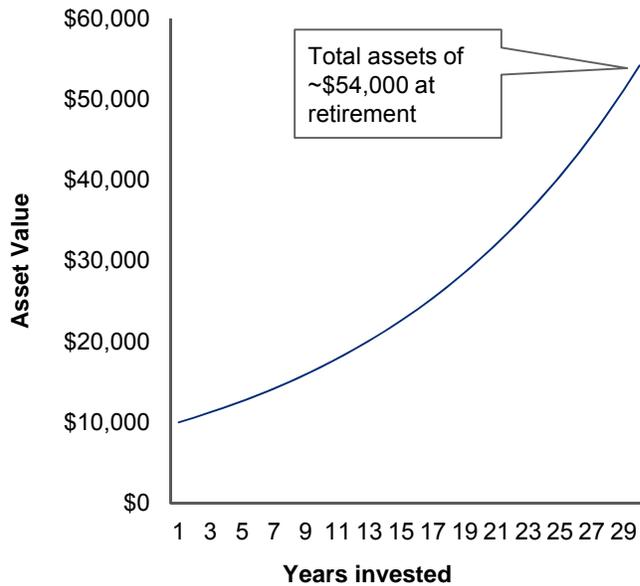
The value of remaining invested is illustrated in a worked example, shown in Figure 26, where we contrast the potential outcomes of two scenarios. In the first scenario, an individual with a \$10,000 account balance takes a cash distribution 30 years prior to retirement. Assuming an early withdrawal penalty of 10%, a federal tax rate of 15% and a state tax rate of 3%, they would have \$7,200 after penalties and taxes. In the second scenario, the individual rolls the same amount of money into an IRA, achieves an average annual return of 6% and is subject to the same combined state and federal 18% tax rate at retirement. In this situation, they would have \$44,280 after taxes, or approximately \$24,500 in current period equivalent dollars, assuming 2% annual inflation – an amount 3.4 times greater.

Figure 26: Worked example comparing a cash distribution with an IRA rollover- Illustrative

Penalty or Tax	Amount
Early Withdrawal Penalty (10% of withdrawal amount)	\$1,000
Required Federal tax withholding	\$2,000
Federal tax withholding refund you should receive	\$500
State tax you will owe	\$300



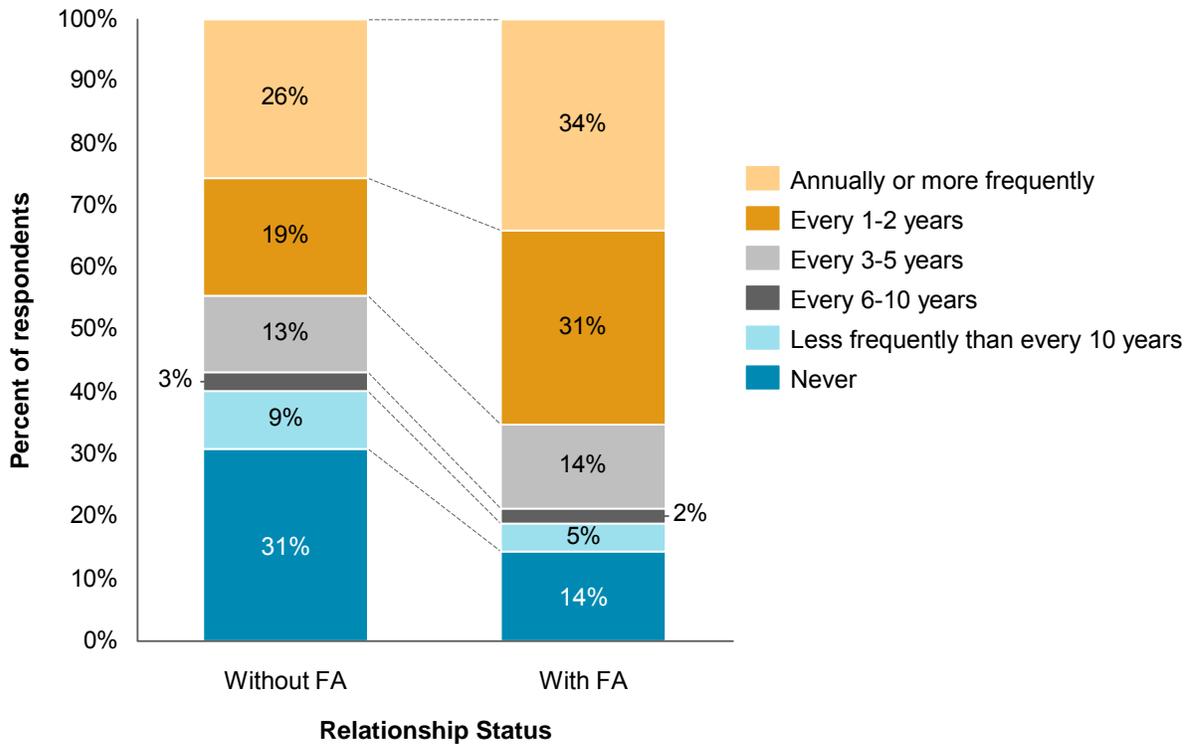
⁵³ Butrica, Zedlewski, Issa, 'Understanding Early Withdrawals from Retirement Accounts', 2010



E. Periodically rebalancing asset holdings to restore desired asset allocation and risk levels – Individuals with financial advisors are 44% more likely to re-balance their portfolios at least every two years

Portfolio re-balancing is an important risk mitigation tool. For example, if an investor’s portfolio is valued at \$100,000, divided equally between equities and fixed income, and the equities portion increases in value by 25% while fixed income increases by a more modest 5%, the overall portfolio value increases to \$115,000. In this case, the equities allocation increases from 50% to 54% of the portfolio value, while the fixed income portion decreases from 50% to 46%. Regular re-balancing restores asset allocations to target levels to reflect investors’ risk return objectives. In our research, individuals with financial advisors rebalanced their portfolios more often than non-advised individuals. 65% of advised individuals re-balanced at least every two years, compared with 45% for non-advised individuals (a difference of 44%). This is illustrated in Figure 27.

Figure 27: Rebalancing frequency outside of DC plans⁵⁴



* * *

Returning to the original question of the value of a financial advisor, the majority of individuals across wealth and age segments, as well as many small businesses, seek professional financial advice, and value their FA as a trusted advisor. We found substantial evidence that advised individuals are more sophisticated and diligent long term investors who achieve better investing outcomes.

The benefits financial advisors provide are now at risk. On April 14, 2015, the Department of Labor issued its Conflict of Interest rule proposal, a replacement for the

⁵⁴ Oliver Wyman Retail Investor Retirement Survey 2014: A KS test is significant at a 95% confidence level

Definition of the term “fiduciary” rule proposal withdrawn in September 2011.⁵⁵ In our 2011 study reviewing the impact of the previously proposed rule, we concluded that the Department of Labor’s proposed rule change was motivated by a laudable objective: to ensure a high standard of care toward retirement plan participants and account holders with regard to the receipt of services and investment guidance, amid an increasingly complex financial marketplace. However, we found the proposed rule was likely to have serious negative and unintended effects on the very individuals the change was supposed to help.

Many stakeholders are now analyzing the technical details of the newly proposed rule, and there is growing consensus on the implications for financial services providers with regard to the prohibited transaction exemptions newly proposed, modified or absent from the proposed rule. However, with regard to the impact on individuals, regrettably we reach the same overall conclusion as in the prior study. The proposed rule change will likely have significant consequences that will adversely impact individual investors’ ability to save for retirement.

- As proposed, financial advisors would be forced to withdraw workplace retirement plan set-up and support services from small businesses, due to the lack of an exception allowing providers to market to plans with fewer than 100 participants that are self-directed –many small businesses are likely to close or not open plans due to the additional administrative burden as a result. This would directly impact the 19 MM individuals who work for small businesses with fewer than 50 employees, who do not currently have access to a workplace retirement plan by reducing the likelihood these individuals will gain access to a plan in the future
- Individuals with small balance accounts are likely to lose access to retirement help and support with selecting appropriate products. We previously estimated that 7 MM current IRAs would not qualify for an advisory account due to low balances⁵⁶
- Almost all retail investors would face increased costs (73% to 196% on average) from providers shifting clients to a fee-based advisory model. In our 2011 study, we found nearly 90% of the 23 MM IRAs analyzed were held in brokerage accounts⁵⁷

⁵⁵ Definition of the Term “Fiduciary”; Conflict of Interest Rule – Retirement Investment Advice, 80 Fed. Reg. 21928, pp. 21927-21960 (proposed Apr. 20, 2015)

⁵⁶ Oliver Wyman, ‘Assessment of the Impact of the Department of Labor’s Proposed “Fiduciary” Definition Rule on IRA Consumers’, 2011

⁵⁷ Oliver Wyman, ‘Assessment of the Impact of the Department of Labor’s Proposed “Fiduciary” Definition Rule on IRA Consumers’, 2011

- Individuals are less likely to open an IRA, leading to lower savings rates and increased cash-outs when changing jobs⁵⁸
- Unadvised individuals are likely to carry excess portfolio risk due to less diversification and less frequent re-balancing compared with advised individuals

* * *

Retirement is too important to get wrong⁵⁹. We encourage key stakeholders from the financial services industry and regulators to join together to find workable solutions that preserve individuals' access to help and support from a financial advisor of their choosing as well as the business model and fees that best meet their needs.

⁵⁸ Prior guidance from the DOL "held that recommendations to a plan participant to take an otherwise permissible distribution, even combined with a recommendation as to how to invest distributed funds, is not fiduciary investment advice." K&L Gates, DOL Re-Proposes Rule to make Brokers, Others, ERISA Fiduciaries (Apr. 27, 2015), <http://www.klgates.com/dol-re-proposes-rule-to-make-brokers-others-erisa-fiduciaries-04-27-2015>.

⁵⁹ [C]onstraints on the availability of investment services that could result from the DOL's reproposal, particularly for smaller plans or individual retirement investors, can undermine the retirement system in various ways." Sutherland, Legal Alert: DOL Reproposes Expanded ERISA Fiduciary Definition and Revised Complex of Exemptions (Apr. 21, 2015), <http://www.sutherland.com/NewsCommentary/Legal-Alerts/172823/Legal-Alert-DOL-Reproposes-Expanded-ERISA-Fiduciary-Definition-and-Revised-Complex-of-Exemptions>.

Survey methodology

Our small business survey had 1,216 valid complete responses by owners and HR decision makers of payroll-based businesses with between 1 and 100 employees. We employed a stratified sampling approach designed to control for the size of the business and ensure that a sufficient number of businesses were recorded that did and did not consult with financial advisors. Furthermore, we selected three company size cohorts for analysis, namely 1–9, 10–49, and 50–100 employees, based the alignment of these segments with data available on employee retirement plan access for comparison purposes. This design allowed us to isolate the impact that financial advisors have upon small businesses. Where appropriate, we report conclusions that are statistically significant at a 95% confidence level using standard methods of statistical inference.

Our retail investor survey had 4,393 valid complete responses by non-retired individuals with investments or retirement accounts. Responses were excluded from respondents who, at the time of the survey, were: under age 18; retired; not at least partially responsible for financial decision making; and non-investors, meaning they did not have at least one investment or retirement account. In addition, we excluded incomplete responses and those completed in less than 1/3 of the median time to ensure a robust data set. Any figures that we report describe this specific sub-population.

Our stratified sampling approach in this case controlled for age and income as well as the presence of a financial advisor. In designing the sample this way, we strove to control for the effects that age and income have upon investment decisions and retirement planning. However, as our sample does not match the composition of the overall population, we utilize scale factors in our analysis to correct for respondent bias, by underweighting sample responses that are overrepresented relative to the population and vice-versa. Although we sampled based upon age, income and the presence of a financial advisor, we scale our sample to the population using age, assets, and the presence of a financial advisor, as the distribution of household assets is better documented in secondary sources than the distribution of personal income. We obtained the population distribution of household age and assets for FA advised and non-FA advised households from the survey of Consumer Finances, a triennial cross-sectional survey of US families conducted by the Federal Reserve. We utilized the 2013 survey data. We report conclusions that are statistically significant at a 95% confidence level.

Appendix I.

Methodology for analysis of U.S. retail investor assets

Our analysis leveraged IXI Services data containing segment-level detail on U.S. consumer invested assets. Segments were defined by specific age tiers (five), income tiers (eleven), wealth tiers (seven), advisor relationship type (Full Service Brokerage vs. Discount Brokerage) and year. For the purposes of this report, we refer to the Full Service Brokerage relationship as “with financial advisor” and the Discount Brokerage relationship as “without financial advisor.”

IXI data contained information on total segment:

- Assets and IRA holdings
- Asset class distribution
- Number of households / accounts

We used two datasets from IXI, which were distinct in the following ways:

Dataset name	1. Household Point-In-Time	2. Account Time Series
Time period	2012-2013	2006-2013
Count type	Households ⁶⁰	Accounts
2013 Assets	\$5.6 TR	\$9.7 TR
2013 Population	21 MM households	71 MM accounts
Segment criteria	Only households with recorded age, income and wealth segment	Includes accounts with no recorded age

While the age segment criterion was analyzed in the Account Time Series dataset, it was ultimately eliminated to capture a broader representation of US invested assets. This is due to a data limitation whereby only 60% of accounts were associated with a specific age. All findings in this study were confirmed across all age, wealth, income, and time segments in both the Household Point-In-Time and Account Time Series datasets unless indicated otherwise.

Findings were generated by comparing the segment-level averages of the various metrics listed above between the Full Service and Discount Brokerage populations. In drawing conclusions from this granular segment-level comparison, we disregarded segments with fewer than 500 households (Household Point-In-Time) or 500 accounts

⁶⁰ IXI could only aggregate account holdings from a single household within a given institution and could not aggregate households' holdings across institutions

(Account Time Series) to eliminate segments with insufficient data points. This resulted in the exclusion of 0.01%-0.04% of the population.

Appendix II.

Automated solutions to address inertia in retirement plans do not guarantee optimal retirement outcomes

It has been well-documented that retirement outcomes are significantly impacted by the status quo bias that leads DC plan participants to prefer their current state both in terms of non-participation and nature of participation⁶¹. This not only affects contribution rates but also asset allocations, both with respect to rebalancing and following a risk allocation glide path to match investor risk profiles at various ages.

Standard default contribution rates do not appear to generate sufficient asset levels for retirement.

Automatic features can impact participant behavior, a notable example being auto-enrollment features which have been shown to increase plan participation by 45%.⁶⁵ However, while encouraging participation is certainly a step in the right direction, according to EBRI, the most common default contribution rate within a workplace retirement plan was just 3% in 2012⁶². This falls well short of an ideal default path to encourage sufficient retirement savings, which is suggested by Prudential as, “A 5–6% default deferral rate with a 2% annual acceleration up to a cap of at least 10–12%”⁶⁵. Unfortunately, only 21% of plans had an automatic escalation feature in 2013⁶³, leading us to conclude that inertia leads many participants continue to save at sub-optimal default contribution rates.

The illustrated example shown below in Figure 28 confirms that for the average individual, a 3% savings rate results in sub-optimal retirement savings. The example utilizes the median income by age according to the US Census, which assumes that an income of approximately \$36,000 at age 25 grows to an income of \$58,000 at age 65. In addition, we utilize a constant 3% contribution rate consistent with the most common default rate, and 6% annual returns. These assumptions lead to a total asset value of approximately ~\$220,000 at age 65, which at approximately 3.8 times the illustrative ending salary falls short of industry recommendations that suggest that individuals save 8 times their ending salary⁶⁴, or approximately \$460,000 in this case. In order to retire

⁶¹ Overcoming Participant Inertia: Prudential Research: (http://research.prudential.com/documents/rp/Automated_Solutions_Paper-RSWP008.pdf)

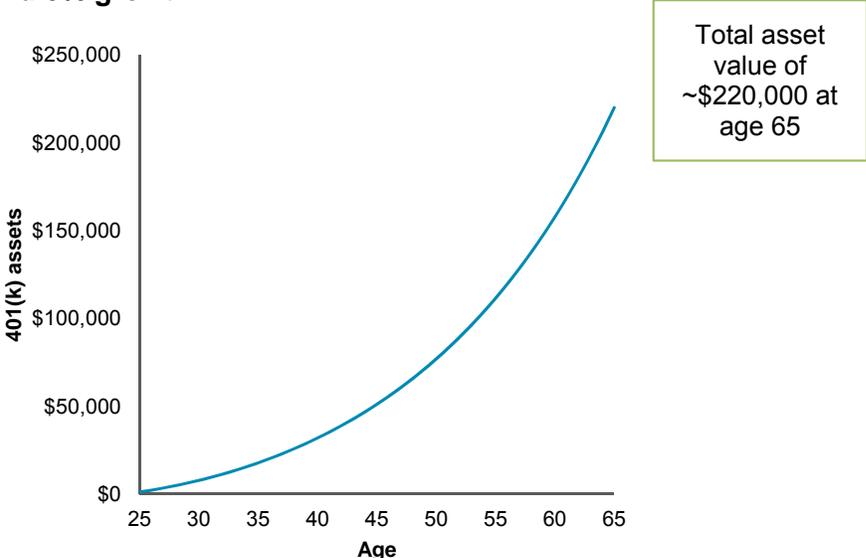
⁶² EBRI September 2012 notes: (http://www.ebri.org/pdf/notespdf/EBRI_Notes_09_Sept-12.HCS-AE.pdf)

⁶³ JP Morgan Asset Management, 2013 defined contribution Plan Sponsor survey Findings: Evolving Toward Greater Retirement Security

⁶⁴ Fidelity Investments, ‘Fidelity Outlines Age-Based Savings Guidelines to Help Workers Stay on Track for Retirement’, September 2012, (<http://www.fidelity.com/inside-fidelity/employer-services/age-based-savings-guidelines>)

comfortably while contributing only 3%, our individual would need to work until age 77. Conversely, contributing an annual average of 6.3% would allow for retirement by age 65.

Figure 28: Example retirement assets by year at median income, 3% contribution rate, and 6% growth



Report qualifications/assumptions and limiting conditions

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