



VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS  
AND INDEPENDENT FINANCIAL ADVISORS

## VIA ELECTRONIC MAIL

August 7, 2017

Employee Benefits Security Administration  
Office of Exemption Determinations  
U.S. Department of Labor  
200 Constitution Avenue, NW  
Suite 400  
Washington, DC 20210

Re: RIN 1210-AB82: Request for Information Regarding the Fiduciary Rule and Prohibited Transaction Exemptions

Dear Deputy Assistant Secretary Hauser:

On July 6, 2017, the Employee Benefits Security Administration of the Department of Labor (DOL) published a request for information (RFI) in connection with its examination of the final rule defining who is a “fiduciary” of an employee benefit plan for purposes of the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code (IRC), as a result of giving investment advice for a fee or other compensation with respect to assets of a plan or IRA (Fiduciary Rule).<sup>1</sup> The RFI seeks public input about possible additional exemption approaches or changes to the Fiduciary Rule.

The Financial Services Institute<sup>2</sup> (FSI) appreciates the opportunity to respond to this important request for comment. FSI supports a carefully-crafted, uniform fiduciary standard of care applicable to all financial advisors providing personalized investment assistance to retail clients.<sup>3</sup> However, we believe that this standard of care should reflect input not only from the DOL but also the Securities and Exchange Commission (SEC), and the Financial Industry Regulatory Authority (FINRA). FSI believes the Fiduciary Rule as it is currently written not only fails to achieve its intended goals, but indeed harms the very investors it was designed to protect. The Fiduciary Rule’s increased compliance costs and litigation risk have caused firms to reduce their product and service offerings, depriving investors of vital personal retirement planning services. Fortunately,

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<sup>1</sup> U.S. Department of Labor, Request for Information, Definition of the Term Fiduciary (July 6, 2017) available at: <https://www.federalregister.gov/documents/2017/07/06/2017-14101/request-for-information-regarding-the-fiduciary-rule-and-prohibited-transaction-exemptions>.

<sup>2</sup> The Financial Services Institute (FSI) is an advocacy association comprised of members from the independent financial services industry, and is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has been working to create a healthier regulatory environment for these members so they can provide affordable, objective financial advice to hard-working Main Street Americans.

<sup>3</sup> See, e.g., Letter from David T. Bellaire, Executive Vice President & General Counsel, Financial Services Institute, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission (Jul. 5, 2013) (commenting on Duties of Brokers, Dealers, and Investment Advisors, Release No. 34-69013; IA-3558; File No. 4-606), available at <https://www.sec.gov/comments/4-606/4606-3138.pdf>.

we believe that this outcome is still avoidable. We offer more detailed feedback below along with suggestions as to how the Fiduciary Rule could better achieve its goals without causing unintended harm to investors.<sup>4</sup>

### **Background on FSI Members**

The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the US, there are approximately 167,000 independent financial advisors, which account for approximately 64.5% percent of all producing registered representatives.<sup>5</sup> These financial advisors are self-employed independent contractors, rather than employees of the Independent Broker-Dealers (IBD).

FSI's IBD member firms provide business support to independent financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions. Independent financial advisors are small-business owners with strong ties to their communities and know their clients personally. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans. Their services include financial education, planning, implementation, and investment monitoring. Due to their unique business model, FSI member firms and their affiliated financial advisors are especially well positioned to provide Main Street Americans with the financial advice, products, and services necessary to achieve their investment goals.

FSI members make substantial contributions to our nation's economy. According to Oxford Economics, FSI members nationwide generate \$48.3 billion of economic activity. This activity, in turn, supports 482,100 jobs including direct employees, those employed in the FSI supply chain, and those supported in the broader economy. In addition, FSI members contribute nearly \$6.8 billion annually to federal, state, and local government taxes. FSI members account for approximately 8.4% of the total financial services industry contribution to U.S. economic activity.<sup>6</sup>

### **Discussion**

While FSI strongly supports the implementation of a uniform fiduciary standard of care, we have long expressed significant concerns with the DOL's Fiduciary Rule because we believe it will harm investors by reducing their access to personal retirement planning services. Firms now have substantially more knowledge about the Fiduciary Rule's requirements, appropriate compliance strategies, and costs. A growing body of evidence demonstrates that the Fiduciary Rule is resulting in higher costs for the industry, which are passed to consumers in the form of

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<sup>4</sup> FSI is a party to a legal challenge to the Fiduciary Rule. Our response to the DOL's RFI and our effort to offer solutions to the issues we identify with the Fiduciary Rule should not be interpreted as being in conflict with the arguments raised in that case. We remain committed to pursuing that matter. See U.S. Chamber of Commerce et al. v. U.S. Department of Labor et al., case number 17-10238, before the U.S. Court of Appeals for the Fifth Circuit.

<sup>5</sup> The use of the term "financial advisor" or "advisor" in this letter is a reference to an individual who is a registered representative of a broker-dealer, an investment adviser representative of a registered investment adviser firm, or a dual registrant. The use of the term "investment adviser" or "adviser" in this letter is a reference to a firm or individual registered with the SEC or state securities division as an investment adviser.

<sup>6</sup> Oxford Economics for the Financial Services Institute, The Economic Impact of FSI's Members (2016) [http://www.financialservices.org/uploadedFiles/FSI\\_Content/Newsroom/Publications/Research/FSI-Impact-Report-Final.pdf](http://www.financialservices.org/uploadedFiles/FSI_Content/Newsroom/Publications/Research/FSI-Impact-Report-Final.pdf).

reduced product choices and a loss of access to much needed retirement planning services. This information necessitates a reconsideration by the DOL of the assumptions underlying the Fiduciary Rule to ensure it does not harm the very investors it hopes to help.

To respond to the RFI, FSI surveyed its members regarding their experience in implementing the Fiduciary Rule.<sup>7</sup> Their responses indicate that the Fiduciary Rule is resulting in a reduction in product choice that was not explicitly included in the cost-benefit analysis performed by the DOL during the rulemaking process. Our members indicate they are limiting product choice in response to the Fiduciary Rule for several reasons, including: the large fixed costs to establish the necessary data feeds from product manufacturers and mutual fund families; the increased risk of class action and other litigation; and the complexity of compliance. These factors are causing firms to alter their business strategies in ways that limit the investment vehicles they offer to investors. For instance, many firms are considering whether they must eliminate A-Share mutual fund offerings, the low cost direct-to fund business, and other offerings that benefit investors. This leads us to conclude that, the DOL overstated the Fiduciary Rule's benefits by failing to account for the reduction in product choice.

Our survey also found that the actual implementation costs to broker-dealers are nearly three times the DOL's previous estimates.<sup>8</sup> Extrapolating to other affected entities, this would imply total costs of \$39 billion–\$47 billion, an amount that already exceeds the DOL's benefit estimates.<sup>9</sup> Such costs will be passed along to investors. A 2017 report estimated that the Fiduciary Rule will increase consumer costs by approximately \$800 per account, or over \$46 billion in the aggregate.<sup>10</sup> The combination of lower fees and high fixed transaction costs means that it is no longer economical for many financial advisors to serve smaller clients. Whereas all firms interviewed reiterated their commitment to meeting the needs of smaller investors, many suggested that below certain asset levels smaller investors will be directed to web-based products that do not rely on a financial advisor. The range of asset size at which this transition is expected to occur varied from \$25,000 to \$70,000 in assets per firm interviewed.<sup>11</sup> Moreover, financial advisors are small business with their own overhead expenses to cover; consequently, they indicated to us that their breakeven point may be lower still.<sup>12</sup>

Much of the benefit of retirement planning services results from an advisor's ability to encourage product diversification, and behavioral coaching: encouraging savings; establishing and maintaining long term strategies; and eliminating the emotional decision-making that often arises during periods of market volatility. These benefits are especially critical for lower and middle class investors, and it is imperative that they have access to financial education and guidance as research shows that investors who work with financial advisors save more, are better prepared for their retirement, and have greater confidence in their retirement planning. For example, a study of the positive value of financial advice found that the investment assets of households working with a financial advisor gained 69% more value after four years and grew

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<sup>7</sup> Oxford Economics for the Financial Services Institute, *Encouraging Market Alternatives to the Fiduciary Rule* (2017). Included as Appendix 2 to this document.

<sup>8</sup> *Id.* at 3.

<sup>9</sup> *Id.*

<sup>10</sup> Meghan Milloy, American Action Forum, *The Consequences of the Fiduciary Rule for Consumers* (April 10, 2017), available at: <https://www.americanactionforum.org/research/consequences-fiduciary-rule-consumers/>.

<sup>11</sup> Oxford Economics, *supra* note 6 at 26.

<sup>12</sup> *Id.*

to 290% more value over 15 years, which is 3.9 times the value of assets of a non-advised household.<sup>13</sup> Another study published by Vanguard estimates that access to an advisor adds 300 basis points to an investor's expected return.<sup>14</sup> However, the benefit calculation used by the DOL throughout its rulemaking process undervalued holistic financial and retirement planning services by equating variance in the performance between and within products as being a valid measure of the value of retirement planning services. Regrettably, this miscalculation will have significant consequences to investors who lose access to retirement planning services.

While the DOL has underestimated the costs, it has also overestimated the benefits attributable to the Fiduciary Rule by narrowly basing its benefit calculation on differences in front-loaded (domestic only) mutual fund performance and failing to connect its substantive elements with the expected benefits calculation.<sup>15</sup> Domestic equity mutual funds, however, do not represent all front-end load mutual funds. In fact, while broker-sold mutual funds are seen to underperform self-selected mutual funds when it comes to domestic equities, they typically overperform self-selected mutual funds when it comes to international equities.<sup>16</sup> While the benefits calculations are entirely based on relatively subtle questions of mutual fund choice (i.e., that advisors will select funds with half a percentage point higher annual returns on average as a result of the rule), much of the rule is not tailored to achieving this outcome.<sup>17</sup> We believe this is a significant error that must be revisited in light of the increased costs.

For these reasons, FSI appreciates the DOL delaying the implementation date of the Fiduciary Rule until January 1, 2018, but urges the DOL to adopt a further delay in order to conduct a detailed review of the Fiduciary Rule, its negative impact on investors' access to retirement planning services and products, and new innovations and approaches that may alleviate many of these concerns.<sup>18</sup> Our members support the thoughtful adoption of market-based solutions, which will result in more cost-effective approaches that better serve investors. However, time is required for market solutions to develop, be implemented, and prove acceptable to consumers. We believe that investors are well protected by existing federal and state regulatory structures and the June 9, 2017 application of the Fiduciary Rule's Impartial Conduct Standards, but the tight time frame imposed by the January 1, 2018 implementation date severely restricts the industry's ability to properly develop and implement these emerging market solutions.

Therefore, we urge the DOL to eliminate the Fiduciary Rule's harmful effects and ensure consumer access to retirement planning services and protection under a best interest standard of care by making the following changes, which we discuss in more detail below:

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<sup>13</sup> Claude Montmarquette, Nathalie Viennot-Briot. Centre for Interuniversity Research and Analysis on Organizations (CIRANO), *The Gamma Factor and the Value of Advice of a Financial Advisor*, available at <https://www.cirano.qc.ca/files/publications/2016s-35.pdf>

<sup>14</sup> Kinniry, Jaconetti, DiJosespeh, Zibering & Bennyhoff, Vanguard Research, *Putting a value on your value: Quantifying Vanguard Advisor's Alpha* (September, 2016). See also: David Blanchett & Paul Kaplan, Morningstar, *Alpha, Beta and Now...Gamma* (2013) available at <http://corporate.morningstar.com/euconf3/presentations/David%20Blanchett,%20Morningstar.pdf>; Marsden, Mitchell et. al., *The Value of Seeking Financial Advice*, *Journal of Family and Economic Issues* 32(4): 625-643 (2011).

<sup>15</sup> Oxford Economics, *supra* note 6 at 22.

<sup>16</sup> *Id.*

<sup>17</sup> *Id.* at 23.

<sup>18</sup> Letter from David T. Bellaire, Executive Vice President & General Counsel, Financial Services Institute, to DOL Employee Benefits Security Administration (July 21, 2017), available at <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB82/00042.pdf>.

- Streamline the documentation and disclosure requirements of the Best Interest Contract Exemption (BICE) while eliminating its private right of action;
- Create a single best interest standard applicable to all advisors and investors;
- Revise and broaden the levelized compensation rules;
- Revise rules for IRA rollovers;
- Expand grandfathering provisions to compensation in connection with securities purchased prior to June 9, 2017; and
- Delay the full implementation of the full Fiduciary Rule until April 10, 2019.

We explain our suggested solutions and respond to specific questions asked by the Request for Information in greater detail below.

## **I. Adopt Alternative Enforcement Mechanisms for the Best Interest Contract Exemption**

### **A. Introduction**

As the Fiduciary Rule is implemented, it has become apparent to our members that the private right of action created by the Best Interest Contract Exemption (BICE) is increasing industry costs, which in turn will increase the prices that investors and retirees must pay, and ultimately reduce access to retirement planning services. The private right of action created by the Fiduciary Rule's BICE is certain to result in an increase in litigation, directly contributing to this unnecessary increase in cost to investors. FSI strongly asserts that investor access to retirement planning services can be preserved by cutting the costs associated with the BICE of the Fiduciary Rule.

In 2017, FSI engaged Oxford Economics to conduct another study, "How the Fiduciary Rule Increases Costs and Decreases Choice" (2017 Oxford Economics Study) to update their economic analysis<sup>19</sup> on the impact of the final Fiduciary Rule.<sup>20</sup> The findings of the 2017 Oxford Economics Study are based on the actual experience of FSI member firms implementing measures to comply with the Fiduciary Rule, not assumptions or projections, which makes these figures far more reliable than the DOL's Regulatory Impact Analysis' (RIA) figures. This report indicates that as reported in the 2016 RIA, broker dealer startup costs have been 1.7 times the DOL's estimate, and recurring costs are expected to be 3.5 times the DOL's estimate, with total 10-year costs exceeding DOL estimates by nearly 2.9 times. Extrapolating from these underestimates of costs to

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<sup>19</sup> In 2015, FSI engaged Oxford Economics to Conduct a study on the "Economic Consequences of the DOL Fiduciary Rule" (2015 Oxford Economics Study available at [http://www.financialservices.org/uploadedFiles/FSI\\_Content/Docs/DOL/FSI-Full-Oxford-Economics-Study.PDF](http://www.financialservices.org/uploadedFiles/FSI_Content/Docs/DOL/FSI-Full-Oxford-Economics-Study.PDF)). The study estimated the Fiduciary Rule would result in startup costs ranging from \$1.1 million to \$16.3 million per firm, depending on firm size.<sup>19</sup> The 2015 Oxford Economics Study indicates that their estimates exceed the DOL's totals by significantly larger margins for small and medium sized firms – specifically, 4.6-5.1 times as high; as for large firms – 3.3 times as high. This is due to the DOL's inaccurate estimate of costs for small and medium-sized firms. Where the DOL estimates that medium firms' costs will be only 13.3%, and small firms only 4.8% of large firms' costs, Oxford estimates they will be significantly larger at 20.6% and 6.9%, respectively.<sup>19</sup> The 2015 Oxford Economics Study went on to warn that the DOL "dramatically underestimated" the cost to comply with the Fiduciary Rule and that smaller firms would find it difficult to stay in business once it took hold.

<sup>20</sup> Oxford Economics 2017 Report, "How the Fiduciary Rule Increases Costs and Decreases Choice" (April 2017), available at [http://www.financialservices.org/uploadedFiles/FSI/Advocacy\\_Action\\_Center/The\\_Fiduciary\\_Rule\\_Increases\\_Costs\\_And\\_Decreases\\_Choice.pdf](http://www.financialservices.org/uploadedFiles/FSI/Advocacy_Action_Center/The_Fiduciary_Rule_Increases_Costs_And_Decreases_Choice.pdf).

broker-dealers to all the rules costs, implies a total cost figure of roughly \$39 billion—\$47 billion.<sup>21</sup>

FSI members report that one consequence of the Fiduciary Rule's Best Interest Contract Exemption (BICE) is that the economics of managing small accounts will change such that the fixed cost of servicing the account will exceed revenue that will be earned. For example, the sheer complexity of new transaction-specific process documentation imposes large costs on the advisor with questionable benefit to the client. Our survey found that the Fiduciary Rule requires up to 12 pages of documentation and the required documentation and disclosure take anywhere from 20 minutes to two hours to complete.<sup>22</sup> As a result, many of our IBD member firms indicate that smaller investors will be offered robo-investing type account services or be asked to move their accounts. These small (often entry level, novice investors) would lose access to the personalized retirement planning services vital to their planning for a dignified retirement. While the definition of a small investor varies among our member firms, Oxford generally estimates that the break-even point for servicing an investment account ranges from \$25,000 to \$70,000 in assets.<sup>23</sup> Since the median IRA balance has ranged from \$23,785 to \$33,185 between 2010 and 2014, it is clear that without significant changes the Fiduciary Rule will have a devastating impact on investor access to retirement planning services and small investors will bear the brunt of that impact.<sup>24</sup>

#### B. BICE Private Right of Action Will Harm Investors

The BICE created a private right of action by requiring, as a condition of the exemption, that financial institutions enter into a contract with IRA holders, subjecting financial institutions and advisors to lawsuits for breach of contract on terms and in forums dictated by the DOL. The private right of action, including – and arguably encouraging – the possibility of class action suits, is a major contributor to uncertainty regarding the true costs of the Fiduciary Rule and has been a fundamental element of the opposition to the Fiduciary Rule.

The private right of action creates substantial financial risk for advisors and financial institutions and will not produce benefits to investors that are commensurate with its costs. Industry members estimate that the increased litigation stemming from the inappropriate use of the private right of action in enforcing the BICE will result in between \$70 million and \$150 million in costs to the industry each year.<sup>25</sup> An analysis by the American Action Forum similarly found that firms involved in litigation as a result of the Fiduciary Rule could face annual costs of up to \$150 million.<sup>26</sup> Data shows that lawsuits like the type that would flow from the Fiduciary Rule provide almost no benefit to the class members of the action, but rather primarily benefit their lawyers.<sup>27</sup>

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<sup>21</sup> *Id.* at 12.

<sup>22</sup> *Id.* at 14.

<sup>23</sup> *Id.* at 26.

<sup>24</sup> "Individual Retirement Account Balances, Contributions, Withdrawals, and Asset Allocation Longitudinal Results 2010-2014: The EBRI IRA Database" (January 17, 2017) available at [https://www.ebri.org/pdf/briefspdf/EBRI\\_IB\\_429\\_IRA-Long.17Jan17.pdf](https://www.ebri.org/pdf/briefspdf/EBRI_IB_429_IRA-Long.17Jan17.pdf).

<sup>25</sup> Morningstar, Inc., *Weighing the Strategic Tradeoffs of the U.S. Department of Labor's Fiduciary Rule* (February 2017).

<sup>26</sup> American Action Forum, *The Consequences of the Fiduciary Rule* (April 10, 2017) available at: [www.americanactionforum.org/research/consequences-fiduciary-rule-consumers](http://www.americanactionforum.org/research/consequences-fiduciary-rule-consumers).

<sup>27</sup> Mayer Brown LLP. "Do Class Actions Benefit Class Members? An Empirical Analysis of Class Actions." December 11, 2013. Available online: <http://www.instituteforlegalreform.com/uploads/sites/1/Class-Action-Study.pdf> (last visited April 17, 2017).

A U.S. Court of Appeals judge observed that certification of a class action forces defendants “to stake their companies on the outcome of a single jury trial, or be forced by fear of the risk of bankruptcy to settle even if they have no legal liability.”<sup>28</sup> Defendants are often forced to make a rational economic decision of settling with an extremely litigious plaintiff’s bar instead of spending years on defense and tying up even more money in discovery costs. The result is that attorneys earn big fees, class participants get small settlements, and the costs of litigation gets factored into the price investors must pay to access retirement planning services. As a result, BICE’s private right of action is an inappropriate and ineffective mechanism for enforcement that should be replaced by a means more likely to promote compliance without imposing an unmanageable burden on financial advisors and financial institutions.

In addition, enforcement through private litigation harms investors because it provides a disincentive for financial advisors to provide necessary education. The risk of private litigation is proving counterproductive to the interests of retirement investors by distorting the professional advice they receive. For example:

- A nationally syndicated financial columnist recently reported an instance where an advisor, who had previously recommended managing diversification jointly for the IRAs of a husband and wife with equities in the husband’s IRA and bonds in the wife’s IRA, changed that recommendation in connection with the Fiduciary Rule to recommend diversification in each account. That change plainly was driven by a concern about private liability exposure and not by any substantive “fiduciary” defect in the prior recommendation and may have involved additional cost for the investors.<sup>29</sup>
- FSI’s financial advisors members are reporting that, when asked by a retired investor<sup>30</sup> whether to take cash needed for some specific purpose from a taxable account or a retirement account, the advisor is defaulting to the taxable account out of a perception that there is less risk to the advisor in making that recommendation. That in fact may routinely be the recommendation in the investors “best interest”, but a material driver of that recommendation is the liability concern on the part of the advisor.
- One of the principal benefits to investors of the broker-dealer system in the U.S. has been the opportunity to access a very wide range of investment products and services as appropriate to each investor’s circumstances. However, there is considerable concern over new legal risks created by the Fiduciary Rule. In response to these concerns, many firms are moving toward a more homogenized product offering to reduce variance in product performance within specific product classes. The wider range of products offered, the wider the difference in fees and performance will be. There is a perception among firms that the Fiduciary Rule creates too much opportunity for trial attorneys to exploit these differences in fees and performance through a class action lawsuit. Therefore, many firms are carefully considering how much fee or expected performance variance they are

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<sup>28</sup> *In re: Rhone-Poulenc Rorer, Inc.*, 51 F.3d 1293, 1299 (7<sup>th</sup> Cir. 1995).

<sup>29</sup> Michelle Singletary, New retirement rule may not stop your adviser from giving you bad advice (June 17, 2017) available at: [http://www.journalnow.com/business/columnists/michelle-singletary-new-retirement-rule-may-not-stop-your-adviser/article\\_28c142d8-ee28-5cae-9d1f-b761b1863d4a.html](http://www.journalnow.com/business/columnists/michelle-singletary-new-retirement-rule-may-not-stop-your-adviser/article_28c142d8-ee28-5cae-9d1f-b761b1863d4a.html).

<sup>30</sup> It is almost never advisable to withdraw funds from a retirement account before age 59.5, we use the term ‘retired investor’ to mean one who is 59.5 or older.

willing to offer through varied product selection. As a result, products become homogenized and choice limited.<sup>31</sup>

While it is certainly the case that none of those outcomes is specified in the Fiduciary Rule, each of them is an entirely rational response to the imposition of an exceptionally high fiduciary duty that may be adjudicated after the fact through private litigation in state court.

The DOL did not adequately account for litigation costs and the resulting reduced access to advice in its RIA. The Northern District of Texas found that the “DOL did not specifically quantify potential class action litigation costs.”<sup>32</sup> A Presidential Memorandum instructed the DOL to examine whether the Fiduciary Rule is likely to cause an increase in litigation.<sup>33</sup> The DOL now has an opportunity to address those comments describing the increased litigation costs the Fiduciary Rule imposes on the industry and investors.

Given the above, the most harmful aspect of the BICE is that by design, private litigation is the primary enforcement mechanism. The Fiduciary Rule’s reliance on private enforcement reflects a non-empirical judgment by the DOL that the prohibited transaction enforcement mechanisms enacted by Congress in 1974 and as evolved in practice are inadequate. Those mechanisms are:

- The prohibited transaction excise tax of Code section 4975. As with the overall federal tax system, section 4975 is enforced primarily through voluntary compliance. That is, every taxpayer that owes the section 4975 excise tax has an obligation to pay it without an assessment from the IRS; and
- For ERISA plans, the remedial provisions of ERISA including private litigation.

The consequences of the Fiduciary Rule have spurred other financial services regulators to act: the SEC issued a request for comment on standards of conduct for broker dealers and investment advisors, expressing a desire to collaborate with the DOL to provide clarity for advisors serving retirement investors; states are also introducing legislation and regulations expanding fiduciary status, for example Nevada’s effort is discussed below. In an environment where a broader group of regulators will be holding advisors accountable to fiduciary standards, the creation of a private remedy under BICE and other PTEs loses its justification. And when the risk of private litigation is compromising the ability of advisors to provide best interest advice, elimination of that risk becomes essential to the purposes of the Fiduciary Rule.

As the BICE is implemented, its enforcement mechanism is increasing industry costs, which in turn increases investor costs and reduces access to products and services, ultimately harming investors. Further, the BICE harms investors because it provides a disincentive for financial advisors to provide necessary education. FSI strongly suggests that these negative effects on investors can be reduced by eliminating the BICE’s private right of action, which will reduce industry costs that are passed on to investors and preserve their access to retirement planning services.

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<sup>31</sup> Oxford Economics, *supra* note 6 at 5.

<sup>32</sup> *Chamber of Commerce of the U.S. v. Hugler*, No. 3:16-cv-1476, dkt. 137 at 63 (Feb. 8, 2017).

<sup>33</sup> Presidential Memorandum on Fiduciary Duty Rule, 82 Fed. Reg. 9675 (Feb. 7, 2017).

### C. Alternative to Private Enforcement Mechanism: Coordinated Enforcement

The interests of retirement investors can be better protected – and the goals of the Fiduciary Rule achieved – without a written contract and its consequences for access and costs. To the extent the DOL lacks direct enforcement authority, coordination with regulatory agencies that do have such authority will lead to better targeted results without the wasted resources of meritless litigation. Contractual warranties on policies and procedures would not be necessary, but the substance of those warranties could be converted to conditions of the exemption

As previously discussed, the DOL created the private right of action in the BICE because it lacks another enforcement mechanism. However, other financial regulatory agencies have robust enforcement programs, with which the DOL could coordinate to leverage their expertise and infrastructure. Indeed, the Fiduciary Rule is already relying on enforcement support from the securities and banking regulators in order to administer the PTEs. In contrast to forcing the industry to pay millions of dollars to plaintiffs' attorneys, just to settle cases outside of their merits, leveraging existing information sharing arrangements and entering into memoranda of understanding with other enforcement agencies ensures that amounts recovered benefit the investor and penalties paid go back into the regulatory system to cover the costs of enforcement. Moreover, placing enforcement in the hands of more experienced financial regulators means less likelihood of frivolous suits, reducing costs to the system and producing more direct action against actual wrongdoers.

Further, retirement investors already have an independent, private remedy available in the form of FINRA arbitration. Pursuant to FINRA rules, claims that retirement investors have against FINRA member firms are subject to arbitration and, in the absence of pleading standards for those proceedings, those claims will in the future invoke the Fiduciary Rule. As noted above, FINRA arbitration has proven to be an effective forum for investors, and avoids the delay and expense of private litigation. Consequently, to the extent DOL has determined that retirement investors should have direct rights against broker-dealer firms, those rights already exist in the right to FINRA arbitration, making the contract and warranties under the BICE a needless complication and expense. Again, this is a circumstance where the conditions of the exemption as written will not functionally advance the interests of retirement investors. Enforcement coordination is further discussed in Section III below.

Using private litigation as the primary enforcement mechanism does investors more harm than good. We contend that retirement investors' interests can be better protected without a written contract and its consequences on access and costs through coordination with financial regulatory agencies that already have direct enforcement authority. Placing enforcement in the hands of experienced financial regulators will reduce costs resulting from frivolous litigation and producing more direct action against wrongdoers. In addition, a private remedy for retirement investors already exists in the form of FINRA arbitration, which avoids the delay and expense of private litigation. However, thoughtful interagency coordination will take time and full implementation of the Fiduciary Rule should be delayed beyond January 1, 2018.

### D. Alternatives to Contractual Warranties

The warranties required under the BICE are unprecedented in the DOL's administration of ERISA. The DOL's usual practice, of course, has been to leave the methods and means of meeting fiduciary standards to fiduciaries themselves, as informed by the law of trusts and guidance in the

context of particular fact patterns. Thus, a primary purpose, if not the primary purpose, of the warranties is to serve as an additional basis for contractual liability on the part of fiduciary advisors and financial institutions. If, as submitted above, the private right of action under the BICE is withdrawn as counterproductive, it follows that the warranties can be deleted from the exemption as well.

To the extent the DOL determines to retain the substance of the warranties, they should be reformulated as terms of the exemption rather than contractual warranties. For example, the warranties in section III(d)(1) and (2) that the Financial Institution has and follows written policies and procedures designed to promote adherence to the Impartial Conduct Standards and identifying and mitigating material conflicts of interest can readily be restated as conditions for the relief provided by BICE.

Section III(d)(3) contemplates a warranty that the policies and procedures:

... require that neither the Financial Institution nor (to the best of its knowledge) any Affiliate or Related Entity use or rely upon quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation or other actions or incentives that are intended or would reasonably be expected to cause Advisers to make recommendations that are not in the Best Interest of the Retirement Investor. Notwithstanding the foregoing, this Section II(d)(3) does not prevent the Financial Institution, its Affiliates or Related Entities from providing Advisers with differential compensation (whether in type or amount, and including, but not limited to, commissions) based on investment decisions by Plans, participant or beneficiary accounts, or IRAs, to the extent that the Financial Institution's policies and procedures and incentive practices, when viewed as a whole, are reasonably and prudently designed to avoid a misalignment of the interests of Advisers with the interests of the Retirement Investors they serve as fiduciaries (such compensation practices can include differential compensation based on neutral factors tied to the differences in the services delivered to the Retirement Investor with respect to the different types of investments, as opposed to the differences in the amounts of Third Party Payments the Financial Institution receives in connection with particular investment recommendations).

While FSI agrees that policies and procedures that mitigate the effect of material conflicts of interest are important, the ability to ensure that the policies and procedures comply with an exemption condition is essential to making the exemption structure work for both the industry and for investors. When converting this warranty into an exemption condition, a tighter description of the substance of the written policies and procedures is appropriate to ensure compliance certainty. This description should identify the specific compensation-related conflicts to be addressed by the written policies and procedures. For example, the description could outline policies and procedures addressing the following:

- (i) A supervisory program that employs processes for monitoring when an advisor is approaching a compensation threshold that would:
  - a. Result in a higher payout percentage in the Financial Institution's compensation grid,
  - b. Qualify an Advisor to receive a back-end bonus, or
  - c. Qualify an Advisor to participate in a recognition club;

- (ii) Compensation policies that minimize incentives for advisors to favor one type of product or another, or proprietary products or products for which the Financial Institution has entered into revenue sharing arrangements, over non-proprietary products that do not entail revenue sharing arrangements;
- (iii) A supervisory program that monitors advisors' recommendations around key liquidity events in an investor's lifecycle; and
- (iv) Use of processes and metrics to assess good and bad behaviors on the part of advisors and make appropriate compensation adjustments for advisors based on the assessments.

FSI believes that written policies and procedures that address each of these items will ensure that all financial institutions mitigate the impact of conflicts of interest in a consistent manner. This necessarily benefits investors. Under the current structure, investors shopping for financial professionals would be required to request policies and procedures and compare them between advisors to obtain assurance that the conflicts were being adequately addressed.

Finally, the RFI also asked for information on the extent to which the industry would be willing to contribute to the development of model policies and procedures. FSI is prepared to assist in such a process.

## **II. Streamline BICE Documentation and Disclosures**

### **A. Introduction**

The BICE creates a significant volume of disclosures that are cumbersome and expensive to create, will confuse investors with their sheer volume and complexity, and because of the private right of action created by the Fiduciary Rule, could create immeasurable legal liability. The DOL designed the Fiduciary Rule's BICE to protect IRA investors through these detailed disclosures. However, the significant costs associated with these disclosure requirements will harm investors through by reducing their access to investment products and retirement planning services. The disclosure costs include:

- The practical costs of trying to accumulate and disseminate the information required;
- The direct costs of mailing and distributing the disclosures; and
- The opportunity cost of devoting precious time with clients to discussing paperwork.

The increased administrative burden makes retirement planning services more expensive and difficult to access because financial advisors will find it difficult to meet with the same number of clients in the course of their work day and are unable to work with smaller account balances that do not cover their overhead. Our members report that setting up an IRA takes approximately two hours under the new requirements, making it much more challenging to economically justify working with smaller account balances. While our member firms are committed to meeting the needs of smaller investors, many have indicated that below certain asset levels smaller investors will be directed to web-based products that do not rely on a financial advisor. Oxford Economics describes the problem below:

The range of asset size at which this transition is expected to occur varied from \$25,000 to \$70,000 in assets per firm interviewed. Moreover, financial advisors are small business with their own overhead expenses to cover; consequently, their breakeven point may be

lower still. One financial advisor whom we interviewed reported that although he remains committed to serving small investors, the current economics may not allow for these relationships to continue. As a result, small investors will be doubly disadvantaged. They will lose access to the retirement planning services that will help them increase their retirement assets, and this will then further limit their ability to take advantage of products and services that can enhance financial security during retirement years.<sup>34</sup>

In his Congressional testimony on behalf of FSI, David Knoch, President of 1<sup>st</sup> Global gave the following example of the real-world impact of the BICE disclosure obligations on investors:<sup>35</sup>

Today, in our entry-level investment advisory programs for a fiduciary account with a minimum asset size of \$5,000, the paperwork bundle that the client is required to sign is 191 pages in length. Of these 191 pages, 149 are disclosure, including the delivery of Form ADV and its required inclusions. This means that 78 percent of the paperwork a client signs in our “entry level” investment advisory program is disclosure. If you add the prospectus delivery requirement to the count, a client receives 503 pages of paperwork, totaling 461 pages of disclosure, or 92 percent of the paperwork. Additionally, after the January 1 applicability date, for a small commission-based account, which can be opened with as little as \$50 initial investment utilizing the Best Interest Contract Exemption, we expect the number of pages of paperwork to be 98 pages, with 70 of those pages being disclosure. When prospectus delivery is added, the number swells to 117 of the 145 total pages, or 81 percent of the total paperwork burden imposed on clients.<sup>36</sup>

In addition, the Fiduciary Rule’s website and transaction level disclosure obligations are too burdensome for firms and are not calculated to provide investors the type of information they actually need. The complicated and comprehensive nature of the disclosures makes it highly unlikely that they will be effective in achieving the DOL’s goal of transparency and usability for investors. Investors do not need or want these voluminous and duplicative disclosures, and will not read, refer to, or rely on them. Further, the cost of complying vastly outweighs any marginal usefulness of the disclosures. Experience has demonstrated that more disclosure does not equate to better disclosure. For example, the 1999 Gramm-Leach-Bliley Act required financial institutions to make very detailed annual disclosures to consumers. Critics contended that the resulting notices were long, complex, and written in legalistic jargon that was difficult for consumers to understand. In 2006, Congress directed the financial regulatory agencies to jointly develop a streamlined model financial privacy form.<sup>37</sup> Consumer testing commissioned by the agencies showed that consumers were more likely to read notices that were simple, provided key context up front, and had pleasing design elements, such as large amounts of white space. This testing indicated that notice in the form of a table was more effective than the long notice originally required by

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<sup>34</sup> Oxford Economics, *supra* note 6 at 26.

<sup>35</sup> Impact of the DOL Fiduciary Rule on the Capital Markets: Hearing Before the Subcommittee on Capital Markets, Securities and Investment of the House Financial Services Committee, 115<sup>th</sup> Congress (2017) (testimony of David Knoch, President, 1<sup>st</sup> Global) available at <https://financialservices.house.gov/UploadedFiles/HHRG-115-BA16-WState-DKnoch-20170713.pdf>.

<sup>36</sup> *Id.*

<sup>37</sup> Peter Swire & Kenesa Ahmad, Investment Company Institute, Delivering ERISA Disclosure for Defined Contribution Plans: Why the time has come to prefer electronic delivery (June 2011) available at: [https://www.ici.org/pdf/ppr\\_11\\_disclosure\\_dc.pdf](https://www.ici.org/pdf/ppr_11_disclosure_dc.pdf).

Gramm-Leach-Bliley, which performed poorly on all measures.<sup>38</sup> These findings were successfully incorporated into the agencies' model form and should serve as a guide to the DOL.<sup>39</sup>

The SEC has greater expertise related to investor disclosure regimes and would be well positioned to aid the DOL in drafting its disclosures to maximize their effectiveness. As SEC Commissioner Michael Piowar observed in his comments on this RFI, the SEC has historically made great effort to ensure the accuracy and effectiveness of disclosures to investors.<sup>40</sup> He pointed to the work of the SEC's Office of the Investor Advocate's Policy Oriented Stakeholder and Investor Testing for Innovative and Effective Regulation (POSITIER) Initiative, which is engaged in an evidence-based study of the impacts of proposed policy changes, including disclosure-oriented policies. He contended that, "[r]ather than dismiss out of hand the role of disclosure in policing conflicts of interest, I would strongly encourage the Department to redouble its efforts to work with the Commission and its expert staff, who may bring to bear our decades of experience in enforcing multiple disclosure-based regimes."<sup>41</sup>

Additionally, as firms have worked in the months since the Fiduciary Rule was promulgated to try to scope and begin building technological systems to comply with the transaction level disclosures, it has become apparent that industry-wide changes must be considered, reviewed, structured, and implemented, which would necessitate considerable time and expense that are unrealistic with a January 1, 2018 implementation date. Our members report that they are building databases in order to perform the complex analyses of all available products, channels, fees and expenses to provide such a disclosure, but still have a significant amount of work left to be ready by January 1. Until the databases can be developed and implemented (at least 12 months), they are instituting a manual process, which is time consuming and can often be error-prone.

The DOL has maintained throughout the rulemaking process that "disclosing conflicts alone would fail to adequately mitigate the conflicts or remedy the harm."<sup>42</sup> However, the DOL has not discussed why disclosure coupled with other less burdensome requirements could not offer a superior alternative to the Fiduciary Rule. We believe the post Fiduciary Rule adoption experiences of financial institutions and financial advisors demonstrate the need to reconsider the BICE's disclosure obligations. For these reasons, we urge the DOL to consider an alternative disclosure regime.

## B. Alternative Global Disclosure Document

We suggest that firms should instead be required to deliver a "global" disclosure document about their services, forms of compensation, and material conflicts of interest at the time an account is established. The relevant disclosures should be available on a website maintained

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<sup>38</sup> *Id.*

<sup>39</sup> Final Model Privacy Form under the Gramm-Leach-Bliley Act, 17 CFR Part 248 (2009) available at: <https://www.sec.gov/rules/final/2009/34-61003.pdf>.

<sup>40</sup> Letter from Commissioner Michael S. Piowar, U.S. Securities and Exchange Commission, to the DOL Employee Benefits Security Administration (July 25, 2017) available at <https://www.sec.gov/news/public-statement/piowar-comment-dol-fiduciary-rule-prohibited-transaction-exemptions>.

<sup>41</sup> *Id.*

<sup>42</sup> Definition of the Term "Fiduciary;" Conflict of Interest Rule – Retirement Investment Advice; and Related Exemptions, 81 Fed. Reg 20945 at 20950 (April 8, 2016).

by the firm, and access to it should be deemed equivalent to delivery of the disclosures for existing clients. For example, draft legislation circulated by Representative Ann Wagner (R-MO-2) includes a disclosure requirement at the outset of the account relationship and provides a workable format: a description of the type and scope of services to be provided, the standard of conduct applicable to the relationship, the types of compensation that may be charged, and any material conflicts of interest. It also envisions disclosure of transaction costs on first purchases of new products.<sup>43</sup> We support this model, but believe even it can be simplified for the benefit of investors.

Thus, the DOL could reduce the costs of the Fiduciary Rule without affecting its functional utility for retirement investors by modifying the disclosures required under the BICE. These disclosure provisions would be greatly improved, from both a cost-benefit perspective and from an investor protection perspective, if they were revised as follows:

- If the Financial Institution is already subject to a conflicts disclosure under federal or state law – in the setting of our industry, the Form ADV or the 404a-5 disclosure for ERISA plan participants – no additional disclosure would be required under the BICE. While these other disclosures are not identical to those currently required under the BICE, the differences are not so material as to justify the costs and other detriments of an additional disclosure.
- If the Financial Institution is not subject to a conflicts disclosure obligation, it would post on its website a simple, concise narrative disclosure of the key points about conflicts that retirement investors should understand, in a form that permits ready comparison among Financial Institutions. Those key points are:
  - That the Financial Institution and Advisor are compensated for their services;
  - That compensation may vary among the products and services they offer;
  - That they do or do not offer proprietary products;
  - That they receive third-party payments; and
  - That there are products and services appropriate for a given retirement investor that the Financial Institution does not offer.

The objective is to ensure that, if printed in hard copy, this disclosure could be presented on a single page in an accessible format.

- In either case, specific disclosures about the recommended transaction would be available on request, and retirement investors would be apprised of the opportunity to obtain that information.

The burdensome disclosure and documentation requirements of the BICE harm the very investors they were designed to protect. However, this harm can be avoided by implementing a global streamlined disclosure document as described above. This approach would ensure that the disclosures available to retirement investors are useful to them, at a radically reduced cost. The result would be better informed investors who have access to the retirement planning services they need and desire.

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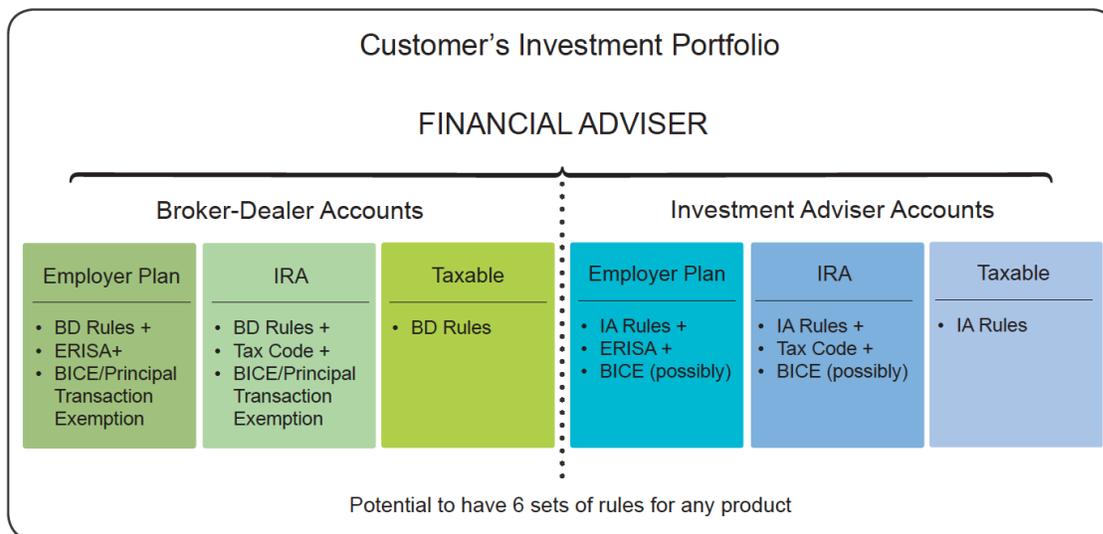
<sup>43</sup> Impact of the DOL Fiduciary Rule on the Capital Markets: Hearing Before the Subcommittee on Capital Markets, Securities and Investment of the House Financial Services Committee, 115th Congress (2017).

### III. Simplify the Regulatory Regime by Leveraging the Expertise of other Regulators

#### A. Introduction

Because of the Fiduciary Rule, the inconsistent standards between tax-qualified and all other accounts have created an unworkable regulatory regime, which is confusing and counterproductive for investors and unworkable for financial advisors. This is because the Fiduciary Rule fails to recognize that most clients are actually household units that have both qualified and non-qualified accounts. As FINRA observed in its comments on the proposed Fiduciary Rule:<sup>44</sup>

The Proposal would impose a best interest standard on broker-dealers that differs significantly from the fiduciary standard applicable to investment advisers registered under the federal and state securities laws, and it would impose the best interest standard only on retirement accounts. This fractured approach will confuse retirement investors, financial institutions, and advisers. Below is a depiction of the panoply of regulatory regimes that will apply under the Proposal to different accounts served by the same financial adviser for a single customer.



The increased costs of complying with overlapping regulatory regimes, some of which rely on private litigation to enforce its complex requirements, is causing higher prices and reduced investor access to retirement planning services. These problems can be addressed most effectively through increased coordination and cooperation between the relevant regulatory authorities. Unlike the DOL, the SEC has existing examination and enforcement protocols and trained staff to perform these important functions. Similarly, the NAIC has valuable expertise in regulating the insurance industry, including regulation of financial professionals who sell insurance products. They

<sup>44</sup> Letter from Marcia Asquith, Senior Vice President and Corporate Secretary, Financial Industry Regulatory Authority, to Department of Labor, Employee Benefits Security Administration (July 17, 2015) available at: <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB32-2/00405.pdf> <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB32-2/00405.pdf>.

must be part of the solution if we are to ensure investors retain access to a wide array of investment options and retirement planning services.

Recent statements by Secretary of Labor Alexander Acosta and SEC Chairman Jay Clayton indicate that they understand the SEC's unique expertise in the regulation of broker-dealers and investment advisors necessitates close coordination between the regulators. "The SEC has important expertise and they need to be part of the conversation," Secretary Acosta said to the Senate Appropriations subcommittee on labor and health and human services.<sup>45</sup> "It's my hope that...the SEC will continue to work with the Department of Labor on this issue." In recent remarks to the Economic Club of New York, Chair Clayton observed that, "with the Department of Labor's Fiduciary Rule now partially in effect, it is important that the Commission make all reasonable efforts to bring clarity and consistency to this area. It is my hope that we can act in concert with our colleagues at the Department of Labor in a way that best serves the long-term interests of Mr. and Ms. 401(k)."<sup>46</sup>

FSI is encouraged by these statements. However, we recognize that coordination between the DOL, SEC, FINRA, and the state insurance regulators to develop a common approach will require thoughtful and meaningful work. Not only will it take time to develop a uniform best interest standard, but once developed the DOL, SEC and other regulators will need to engage in and coordinate their respective rulemaking processes, which will necessarily include notice and comment periods. The SEC has already issued a request for comment regarding standards of conduct for investment advisors and broker-dealers to evaluate potential regulatory actions in light of current market conditions, but this is just the start of their rulemaking process.<sup>47</sup> A collaborative effort will take more time than the current January 1, 2018 implementation date allows. An extension of the implementation date is necessary to avoid the harm to investors that is resulting from disparate regulatory regimes. We offer a solution in further detail below.

#### B. Modification of Impartial Conduct Standards.

The impartial conduct standards, introduced in the BICE and exported into existing exemptions, consist of three underlying standards: (1) investment advice must be in the "best interest" of the retirement investor; (2) compensation for such advice must not be in excess of reasonable compensation; and (3) any statements made in connection with that advice must not be materially misleading. The best interest standard is described as follows:

Investment advice is in the "Best Interest" of the Retirement Investor when the Adviser and Financial Institution providing the advice act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, without regard to the financial or

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<sup>45</sup> Mark Schoeff, *Labor's Alexander Acosta and SEC's Jay Clayton tell lawmakers they will work together on fiduciary rule*, Investment News (June 27, 2017) available at: <http://www.investmentnews.com/article/20170627/FREE/170629931/labors-alexander-acosta-and-secs-jay-clayton-tell-lawmakers-they>.

<sup>46</sup> Jay Clayton, Chairman, U.S. Securities and Exchange Commission, Remarks at the Economic Club of New York (July 12, 2017) available at: <https://www.sec.gov/news/speech/remarks-economic-club-new-york>.

<sup>47</sup> Jay Clayton, Chairman, U.S. Securities and Exchange Commission, Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisors and Broker-Dealers (June 1, 2017) available at: <https://www.sec.gov/news/public-statement/statement-chairman-clayton-2017-05-31>.

other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party.

This language differs from existing fiduciary standards – including that of ERISA itself (and while the DOL has explained in the preamble that the BICE standard is intended to be identical in substance to the ERISA section 404(a) standard, it has not credibly explained this difference in language).

There is, of course, a body of federal and state fiduciary law that already applies to financial institutions and financial advisors outside of these exemptions, notably including:

- ERISA itself, to the extent the financial institution and advisor is acting as an investment advice fiduciary to an ERISA plan or participant;
- The Investment Advisers Act of 1940, if the financial institution is a registered investment adviser;<sup>48</sup>
- The fiduciary standards administered by the Federal Reserve Bank and the OCC, if the financial institution is federally chartered bank, or similar state laws for state chartered banks<sup>49</sup>; and
- The fiduciary standards mandated by the Municipal Securities Rulemaking Board for municipal advisers.<sup>50</sup>

In addition, the SEC is considering the prospect of a uniform fiduciary standard for financial advisors to retail investors including retirement investors, which the SEC has under consideration and which FSI has long supported; states such as Nevada have instituted laws to similar effect.<sup>51</sup> These standards were all developed for a specific setting – ERISA plans, or a particular type of financial institution – and in that respect are more tailored than the universal “best interest” standard of the Fiduciary Rule.

The DOL based the Fiduciary Rule on examples that arise in circumstances where no fiduciary standard applies under the other laws outside of the DOL’s exemptions. There is no material showing that these standards are inadequate to the purposes of protecting retirement

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<sup>48</sup> Registered investment advisors are subject to a fiduciary duty under the Advisers Act, which has developed through Federal common law. The SEC has described it on its website as including “a fundamental obligation to act in the best interests of clients...[and] a duty of undivided loyalty and utmost good faith.

<https://www.sec.gov/divisions/investment/advoverview.htm>.

<sup>49</sup> See, e.g., 12 CFR § 9.12. Where a national bank has investment discretion over fiduciary accounts that it acquired from itself, its affiliates or other related parties, or any other individuals or organizations with a potential conflict of interest that might affect the national bank’s best judgment, the national bank cannot invest such funds unless otherwise authorized by law. Similarly, except under certain narrow circumstances, national banks with investment discretion over fiduciary accounts cannot lend, sell, or transfer such assets to any such related parties.

<sup>50</sup> Mun. Sec. Rulemaking Bd., Rule G-42, as updated by Exchange Act Release No. 34-76753, 80 Fed. Reg. 81614 (Dec. 30, 2015), File no. SR-MSRB-2015-03. Consistent with the statutory fiduciary duty owed under Section 15(c)(1) of the Securities Exchange Act of 1934 (Exchange Act), a municipal advisor engaging in municipal advisory activities on behalf of a municipal entity client is subject to a fiduciary duty which includes a duty of care and a duty of loyalty. Municipal advisors must also disclose all material conflicts of interests, inform their clients in writing of any direct or indirect compensation, and ensure that all recommendations are reasonable (and inform the client as to the risks, reasoning, and any feasible alternatives to the recommended investment).

<sup>51</sup> S.B. 383, 2017 Leg., 79<sup>th</sup> Session (NV 2017) available at: <http://nvsos.gov/sos/licensing/securities/new-fiduciary-duty>

investors. Indeed, in explaining the basis for the Fiduciary Rule, the DOL has often said that “[w]hile many financial advisers acted in their customers’ best interest, not everyone was *legally required* to do so.”<sup>52</sup>

At a minimum, similar to the conclusions it reached with respect to “level fee” fiduciaries, the DOL can fairly conclude that, when a financial institution and financial advisor is independently subject to federal or state fiduciary standards, the risk of adverse consequences to retirement investors from conflicts is so attenuated that the DOL can provide exemptive relief on more streamlined conditions. FSI proposes that the BICE be amended (with conforming revisions to other exemptions) to include an additional exemption for “fiduciary advisors” – i.e., advisors that are “legally required” to act in the best interest of customers under other bodies of law – to the effect that the relief provided by the exemption is available if:

- The financial institution and advisor is subject to a fiduciary duty to retirement investors under federal or state law;
- Their compensation does not exceed reasonable compensation;
- Any statements made in connection with their recommendations are not materially misleading; and
- They provide disclosures in the manner described above.<sup>53</sup>

Under this approach, the DOL’s “best interest” standard itself would govern in circumstances where no other fiduciary standard was in effect. The problems with multiple articulations of a best interest standard of care would be avoided while retaining the remaining two impartial conduct standards – reasonable compensation and no materially misleading statements. Constructive engagement between the DOL, SEC, FINRA, and the NAIC will ensure these regulations are workable and appropriate for their respective industries. Further, this consistent standard could also serve as the basis for an alternative PTE available to firms and advisors who are subject to a substantially similar best interest standard adopted by another regulator. Appendix 1 to this comment letter presents a proposed articulation of this standard. We urge the DOL to consider its adoption.

#### **IV. Revise and broaden the levelized compensation rules**

##### **A. Introduction**

The Fiduciary Rule offers streamlined compliance requirements to Level Fee Fiduciaries. A “Level Fee” is a fee or compensation provided on the basis of a fixed percentage of the value of the assets or a set fee that does not vary with the particular investment recommended, and does not include a commission or other transaction-based fee. The DOL has explained that such an approach would reduce conflicts of interest with respect to mutual fund recommendations, therefore reducing the need for heightened surveillance around advisor conflicts of interest. As a result, many firms have transitioned their brokerage accounts to these fee-based advisory

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<sup>52</sup> Consumer Protections for Retirement Investors – FAQs on Your Rights and Financial Advisers, Q&A-6 (January 2017) (emphasis added), previously published on EBSA’s website.

<sup>53</sup> While this solution is not a true uniform standard, it creates a pathway through which the SEC could create a single standard for broker-dealers and investment advisors that applies to both retirement and non-retirement accounts. NAIC could follow suit by addressing the standard of care due to investors in insurance products.

accounts to avoid having to rely on the BICE. Recent media reports have highlighted the decisions being made by some firms to change their service models and product availability, including (a) moving clients to fee-based accounts, (b) eliminating commission-based IRAs; (c) raising investment minimums for commission-based IRAs; (d) eliminating variable annuity products; and (e) excluding certain products from commission-based IRAs (e.g., annuities, mutual funds, and exchange-traded funds).<sup>54</sup> These decisions simplify and rationalize the compliance obligations for firms and financial advisors, but can have unfortunate impacts on some investors by depriving them of access to products, lower cost investment options, or access to retirement planning services.

Recent product innovations may create opportunities to achieve the Fiduciary Rule's goals at a lower cost to firms and investors, but more time is needed for these to come to fruition. Broadening the availability of the leveled compensation rules would allow firms to offer Wholesale Shares (also known as "Clean Shares"), T-shares, fee-based variable annuities and other product innovations to create level fee arrangements using commissionable products.<sup>55</sup> Unfortunately, these efforts will take considerable time to come to fruition. For example, American Funds, Janus and Columbia Threadneedle are reported to be the only companies to issue "clean" shares<sup>56</sup> of their mutual funds thus far.<sup>57</sup> As mutual fund, insurance and other companies develop new share classes or other pricing options, clearing and introducing firms must wait to develop the necessary trading, surveillance, commission and other systems to support their use. Due to the sequential nature of the various intermediaries' development of the necessary systems, it is doubtful that wholesale shares, other new share classes, or product options, can be fully operationalized for at least 18 – 24 months.

As previously discussed, the impartial conduct standards prohibit the financial institution, financial advisor, and their affiliates from receiving more than "reasonable compensation." FSI members support the concept of reasonable compensation, but the standard as written is too vague, creates significant compliance challenges, and stifles innovation. Under proper analysis, the reasonableness of compensation is determined based on the particular facts and circumstances at the time of the transaction is entered into. It is informed by several factors, including the market pricing of the services provided, the scope of investment monitoring and the complexity of the product. While the DOL has asserted that reasonable compensation does not mean that the lowest cost product must always be sold, we remain concerned that absent specific

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<sup>54</sup> See: Wursthorn, *New Retirement Rule Is Delayed, but Not Its Impact*, Wall St. J. (Apr. 8, 2017); Wursthorn, *A Complete List of Brokers and Their Approach to "The Fiduciary Rule,"* Wall St. J. (Feb. 6, 2017). See Also: Letter from Richard Foster, Senior Vice President and Senior Counsel for Regulatory and Legal Affairs, Financial Services Roundtable, to Department of Labor, Employee Benefits Security Administration (April 17, 2017) available at: <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB79/01309.pdf>.

<sup>55</sup> Greg Iacurci, *In new fiduciary rule FAQs, DOL gives quasi-endorsement of clean shares*, Investment News (May 23, 2017) available at: <http://www.investmentnews.com/article/20170523/FREE/170529973/in-new-fiduciary-rule-faqs-dol-gives-quasi-endorsement-of-clean>.

Letter from Richard Foster, Senior Vice President and Senior Counsel for Regulatory and Legal Affairs, Financial Services Roundtable, to Department of Labor, Employee Benefits Security Administration (April 17, 2017) available at: <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB79/01309.pdf>.

<sup>56</sup> As described in a 2017 SEC staff interpretive letter, clean shares are a class of shares of a mutual fund without any front-end load, deferred sales charge, or other asset-based fee for sales or distributions. See Capital Group, SEC Staff Letter (Jan. 11, 2017), [www.sec.gov/divisions/investment/noaction/2017/capital-group-011117-22d.htm](http://www.sec.gov/divisions/investment/noaction/2017/capital-group-011117-22d.htm).

<sup>57</sup> Greg Iacurci, Investment News, "In new fiduciary rule FAQs, DOL gives quasi-endorsement of clean shares" (May 23, 2017) available at <http://www.investmentnews.com/article/20170523/FREE/170529973/in-new-fiduciary-rule-faqs-dol-gives-quasi-endorsement-of-clean>.

guidance in the context of the exemptions, a de facto presumption in favor of the lowest cost product will be created. For example, virtually all of the 401(k) fee litigation involves an allegation that a large plan sponsor/administrator or other discretionary investment fiduciary breached its duties by choosing certain investment options when, because of the plan's size, the fiduciary could have negotiated for cheaper funds or services.

Given the complexity of retirement issues and savings products, the local courts without experience in ERISA cases may be tempted to adopt this interpretation. Clearly, automatically offering the lowest cost product to all investors in order to ensure compliance with the reasonable compensation standard will in no way benefit investors. Instead, investors will be harmed by losing access to features that may be of great value to them and they will not benefit from upswings in the market like they might have with other, more diverse holdings. Fear of liability arising from lawsuits filed by plaintiffs' attorneys who see the vagueness of the reasonable compensation standards as an opportunity is causing firms to adopt compliance requirements that deprive investors of desirable investment products, pricing options, and retirement planning services. Thus, there is a need for useful guidance on reasonable compensation in order to ensure that investors maintain access to products and services. In particular, guidance is needed regarding the type of benchmarking available, such as comparing market rates and compensation set by product sponsors. We support a principles-based approach to the definition of reasonable compensation while providing the necessary guidance for financial institutions to have confidence in the quality of their compliance efforts.

Additionally, as firms have worked in the months since the Fiduciary Rule was promulgated to try to comply with the vague standard, it has become apparent that industry-wide changes must be considered, reviewed, structured, and implemented. Although the industry has worked diligently to consider how to implement these changes, more time is required for all parties in the product manufacturing and distribution chain to implement all of the necessary adjustments. Firms spend a significant amount of time ensuring clients who are looking for investment performance are accessing the right products for that need. There are similarities between commission options available for products with a similar purpose, but also significant challenges to standardizing commissions when a single product, like fixed indexed annuities, are required to have identical commission structures. Not having the flexibility to consider best interest standards within smaller subcategories would have a significant impact on products available to the client.

For these reasons, FSI urges the DOL to delay the January 1, 2018 implementation date so that it can offer additional guidance and consider other approaches to the reasonable compensation issue. This will also allow the industry the time necessary to develop and implement solutions, including the use of innovative products and pricing models, to address the goals of the Fiduciary Rule without depriving investors of access to retirement planning services.

#### B. Guidance for Determining Reasonable Compensation

While reasonable compensation has long been part of ERISA, the determination of reasonable compensation has always been the purview of the plan-level fiduciary, who is expected to engage in a prudent process to ensure that compensation paid to service and investment providers is reasonable using a market-based determination. Indeed, the very purpose of the 408(b)(2) disclosure regulations is to ensure that the plan level fiduciaries have the information necessary to make that determination.

As currently constituted, however, the BICE requires the financial institution to self-determine that its compensation is reasonable, even though the financial institution is not positioned to have any market information relative to the recommended transaction other than its own. Plan sponsors generally use an RFP process to compare costs for the specific services being offered to that particular plan by various providers – a process which cannot be replicated by providers and, even if it could, would amount to illegal price fixing. With regard to IRAs, it is also unclear how a financial institution can ensure that its costs are comparable with competitors without violating antitrust laws. The economic basis of the market-driven approach behind ERISA's reasonable compensation standard is that the consumers of the services themselves will establish reasonable compensation by not entering into arrangements with costs in excess of those that are reasonable in the marketplace.

If the DOL is going to continue to require, as a condition of an exemption, that a provider determine that its compensation is reasonable, additional guidance is essential. This guidance would serve as a proxy for the process that plan level fiduciaries are expected to follow in evaluating reasonable compensation of service providers, such as the RFP process. The guidance could take the form of safe harbors allowing reliance on compensation standards adopted by other regulators based on "fair and reasonable" considerations (e.g., FINRA's fair prices and commissions rule) and/or guidance in the nature of procedural prudence standards. Not only will this minimize unnecessary risks and uncertainties for the industry, but it will be protective of and safeguard the interests of the retirement investors.

### C. Proposed Safe Harbors

Where a securities regulator has set forth compensation standards, a safe harbor should be created under which compliance with those standards would be deemed to satisfy the reasonable compensation requirement in the exemptions. The identified standards will be those that set forth conditions to ensure compensation is not in excess of reasonable compensation. Examples include:

- FINRA's fair prices and commissions rule and related supplementary material, which establishes fairness standards for markups and commissions charged by member firms for securities transactions;<sup>58</sup>
- FINRA's corporate financing rule, which establishes fair and reasonable standards for compensation (including non-cash compensation) for member firms participating in a corporate financing offering of securities;<sup>59</sup>
- FINRA's direct participation program rule, which establishes fair and reasonable standards for compensation (including non-cash compensation) for member firms participating in an offering of direct participation program securities;<sup>60</sup>

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<sup>58</sup> FINRA, Rule 2121 Fair Prices and Commissions (2014) *available*

at: [http://finra.complinet.com/en/display/display.html?rbid=2403&element\\_id=11539](http://finra.complinet.com/en/display/display.html?rbid=2403&element_id=11539).

<sup>59</sup> FINRA, Rule 5110 Corporate Financing Rule – Underwriting Terms and Arrangements (2008) *available*

at: [http://finra.complinet.com/en/display/display.html?rbid=2403&record\\_id=16010&element\\_id=6831&highlight=5110#r16010](http://finra.complinet.com/en/display/display.html?rbid=2403&record_id=16010&element_id=6831&highlight=5110#r16010).

<sup>60</sup> FINRA, Rule 2310 Direct Participation Programs (2009) *available*

at: [http://finra.complinet.com/en/display/display.html?rbid=2403&record\\_id=16009&element\\_id=8469&highlight=2310#r16009](http://finra.complinet.com/en/display/display.html?rbid=2403&record_id=16009&element_id=8469&highlight=2310#r16009).

- FINRA's investment company rule, which establishes fair and reasonable standards for compensation (including non-cash compensation) for member firms participating in an offering of securities of mutual fund and certain other investment companies;<sup>61</sup> and
- Any rules adopted by the SEC under the Advisers Act.<sup>62</sup>

Also, where the issuer of the security or product is subject to a regulatory requirement imposing fair and reasonable pricing standards on the fees and charges imposed in connection with the security or product, the compensation received by the financial institution from that issuer should be deemed to satisfy an exemption's reasonable compensation requirement. Thus, for example, in the case of variable contracts, the Investment Company Act of 1940 requires the insurance company issuing the contracts to make a representation in the registration statement for the variable contracts that the fees and charges deducted under the contracts, in the aggregate, are reasonable in relation to the services to be rendered, the expenses expected to be incurred, and the risks assumed by the insurance company.<sup>63</sup> A financial institution receiving compensation from an insurer that has made such a representation should be entitled to rely on a safe harbor. Similarly, a financial institution should also be able to rely on a "reasonable compensation" safe harbor if it receives compensation from an insurer for an annuity contract whose terms and features have been reviewed by state insurance regulators under standards requiring an assessment of whether the contract's provisions are fair and reasonable, as is the case for (virtually all) annuities issued to retail investors.

#### D. Alternate Procedural Prudence Guidance

Because all compensation paid in connection with a transaction may not be covered by an identified safe harbor, the DOL should also provide guidance on procedural prudence. This could take the form of an additional safe harbor, similar to that of the annuity purchase safe harbor, or an interpretive bulletin outlining factors that a financial institution should consider in setting its own compensation as well as that of its distribution chain. Whichever form the procedural prudence guidance takes, the following should be included:

- Financial institutions are solely responsible for determining that their own fees (and those that it pays for distribution) are reasonable; and
- Lowest price is not the benchmark for prudence.

A financial institution will satisfy the safe harbor if, at least annually, it (i) surveys from publicly available information the range of compensation for similar services paid in the market and (ii) reasonably determines that the compensation to be received by the financial institution and the advisor is within the range of the market. The objective of the safe harbor is to confirm that the financial institution or the financial advisor is not taking advantage of its fiduciary position to obtain compensation beyond that which an arm's length arrangement would bear. As the Supreme Court reasoned in *Jones v. Harris Associates, LP*, 559 U.S. 335 (2010), interpreting section 36(b) of the Investment Company Act of 1940 which imposes a fiduciary duty on mutual fund advisors as to their fees, "the essence of the test [as to whether a fiduciary duty has been violated] is whether or not under all the circumstances the transaction carries the earmarks of an

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<sup>61</sup> FINRA, Rule 2341 Investment Company Securities (2016) available at: [http://finra.complinet.com/en/display/display.html?rbid=2403&element\\_id=12338](http://finra.complinet.com/en/display/display.html?rbid=2403&element_id=12338).

<sup>62</sup> Investment Advisers Act of 1940, 15 U.S.C. §80b-211(h)(2) (2012).

<sup>63</sup> Investment Company Act of 1940, 15 U.S.C. §80a-26(f) (2012).

arm's length bargain" and "to face liability under Section 36(b), an investment adviser must charge a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's length bargaining."

If procedural prudence is set forth in a safe harbor, the safe harbor should clearly provide that the failure to meet the safe harbor would not mean violation of exemption, but that the current factual market-based standard would apply. The safe harbor would therefore operate as an incentive for financial institutions to engage in a prudent process that is focused on the retirement investor when setting compensation.

## **V. Revise the Fiduciary Rule's Requirements for IRA rollovers**

### **A. Introduction**

The Fiduciary Rule in effect requires a financial advisor to obtain detailed information about the customer's retirement plan, some of which may be in the possession of third parties. The financial advisor and financial institution are not in a position to be able to obtain all of the information necessary to adequately compare the benefits, costs and features of retirement plans for which they have no relationship. It is unrealistic to expect that advisors will be able to obtain accurate information, and thus retirement investors may be disserved in many situations.

The DOL appears to have focused almost exclusively on the fact that the cost to investors in most IRAs is higher than that charged by employer-sponsored retirement programs such as 401(k) plans. This ignores the vast qualitative difference between IRAs and employer-sponsored plans. IRAs offer a wide array of financial products, including individual equities, fixed income investments, mutual funds, Unit Investment Trusts, fixed and variable insurance products, and numerous types of alternative investments which may help investment portfolios achieve higher overall returns with lower levels of risk by employing strategies involving non-correlated and illiquid assets. IRAs also offer a much greater level of personalized advice, which is generally not available in employer-sponsored retirement programs. It is generally true that employer-sponsored plans may have lower costs, but other products offer retirement investors the higher level of service they wish to receive without having to review reams of information about the employer-sponsored plan.

Retirement investors will be better served if, with regard to rollovers, the Fiduciary Rule instead encouraged educational disclosure to clients about rollovers, with a more general disclosure of the cost differences in the event of true investment advice. A broader definition of education as distinct from advice, and a concise disclosure document setting forth the primary differences between employer-sponsored plans and IRAs, would accomplish the DOL's objectives in bringing rollovers within the scope of the Fiduciary Rule.

### **B. Rollover-Specific Revisions to the Fiduciary Rule**

The Fiduciary Rule fails to clearly and properly distinguish between rollover discussions and true investment advice. Treating a rollover discussion the same as a recommendation to purchase or sell securities does not sufficiently address the needs of investors. The Fiduciary Rule should be revised to recognize that distinction and, to the extent a discussion actually involves an investment recommendation, include a streamlined exemption based on information important and unique to investors considering a rollover.

FSI proposes that:

- The definition of fiduciary be revised so that advice on making contributions to tax-qualified retirement plans, including IRAs, are clearly excluded;
- The investment education exception should be clarified with respect to when rollover information is not fiduciary investment advice; and
- A separate streamlined exemption should be developed for use with rollover investment advice, directed specifically to rollover concerns.

C. Recommendations to make regular contributions to retirement plans should not be considered fiduciary investment advice

As suggested by the DOL in RFI 14, a recommendation to make additional contributions to plans or IRAs should be expressly excluded from the definition of investment advice, particularly where the recommendation involves regular contributions within the Internal Revenue Code contribution limits applicable to the plan/IRA. Contributions to qualified retirement plans and IRAs enjoy special tax benefits in order to promote and encourage individuals to save for retirement. Indeed, the very mission of EBSA is to promote that retirement security. The Fiduciary Rule, however, in this regard is operating to completely defeat that purpose and actually discourages experts from educating individuals on the importance of saving for retirement.

Particularly in the case of recommending that an individual make regular contributions to an existing retirement account, the interests of the advisor will almost always be aligned with those of the retirement investor. This is especially true when combined with investment education. This sort of “advice” has never been thought to constitute fiduciary investment advice and should not be considered advice now. The definition of fiduciary investment advice should be amended to expressly exclude contribution recommendations. Proposed language for this exclusion is attached in Appendix 1.

D. The investment education exception should be clarified to clearly articulate the distinction between advice and education in the distribution context

The DOL’s current position, as articulated in the preamble to the fiduciary definition portion of the Fiduciary Rule, is that advice regarding taking distributions is by its very nature investment advice because investments will necessarily have to be held or sold as a result. This is a stark departure from the DOL’s previous position, as well as the common understanding of the meaning of investment advice, and has created an environment under which financial professionals feel constrained to avoid any conversations about distributions. While there may be situations in which investment advice is provided in connection with a rollover discussion, this is not always the case and that should be made clear.

Similarly, because the definition of fiduciary includes recommendations on the use of proceeds of distributions, the investment education exception needs to be expanded to make clear that general discussions of the use of distributions, without advice regarding particular securities or investment property, is not fiduciary investment advice. For example, when an advisor generally encourages an individual, at termination of employment, to refrain from taking a lump sum distribution to make home improvements in favor of rolling over to an IRA or a new employer’s plan, this should be considered financial education rather than advice.

FSI proposes that the investment education exception be amended to make clear that providing general information on distributions, including rollovers, will not be considered investment advice unless (i) it involves a recommendation regarding the purchase of specific securities or the allocation of investments between specific investment options under the IRA or new plan; or (ii) the advisor or financial institution acknowledges that it is acting as a fiduciary in providing rollover advice. Proposed language for this modification is attached in Appendix 1.

#### E. A Streamlined Exemption Specific to Rollover Advice Should be available

In addition to (or as an alternative to) the investment education exception, an exemption specific to rollover advice should be issued. Rollover decisions differ from asset purchase and allocation decisions in important ways, and investors will be better served by an exemption that focuses on the unique considerations important in that regard.

The streamlined exemption would cover the discrete recommendation to rollover from a plan to an IRA or another plan. It would be conditioned upon the provision of (1) a prominent statement making clear that fiduciary investment advice is not being provided; and (2) a written statement describing the following information:

- The four typical options available upon termination of employment;
  - Keep the money in the employer's plan, if permitted;
  - Rollover the assets to the new employer's plan, if applicable and permitted;
  - Rollover to an IRA; or
  - Taking a cash distribution from the plan.
- The relevant differences that should be considered in the rollover decision:
  - The number and types of investment options;
  - Costs and fees of the account (Plans may be cheaper than IRAs);
  - Levels of service;
  - Protection from creditors.
- A succinct fee disclosure statement for the IRA or, in the case of a rollover to another employer plan, the plan's 404a-5 participant disclosure statement.
- A statement that the financial professional may be conflicted in its advice because he only gets paid if the participant chooses to rollover.

A proposed streamlined exemption is attached in Appendix 1.

As it is currently applied, the Fiduciary Rule's requirements for IRA rollovers are harming investors by preventing them from accessing retirement planning services. The previous suggestions and the proposed exemptions in Appendix 1 distinguish properly between rollover discussions and investment advice; clarify that recommendations to make regular contributions to retirement plans should not be considered investment advice; clarify the distinction between advice and education in the distribution context; and create a streamlined exemption specific to rollover advice. This solution will ensure that those planning for a secure retirement have access to guidance to allow them to make educated decisions. We urge the DOL to adopt these changes

#### **VI. Expand grandfathering to orphaned retirement accounts**

Throughout the rulemaking process, FSI members have expressed concern that the Fiduciary Rule would harm investors by limiting their access to retirement savings products and

services. The DOL maintained that the Fiduciary Rule would not result in a greater number of orphaned accounts as industry claimed. However, now that the Fiduciary Rule is partially in effect, the impacts of the rule are better understood. One large mutual fund provider reports that its number of orphaned accounts nearly doubled in the first three months of 2017, and that the average account balance in these orphan accounts is just \$21,000. Further, it projects that ultimately 16% of the accounts it services will be orphaned this year because of the Fiduciary Rule. Extrapolating this prediction suggests that at least 1.6 million small retirement savers have already lost access to investment assistance since January 2017, and an additional 1.6 million are likely to lose access after the Rule becomes applicable.<sup>64</sup> Our member survey indicates financial institutions and financial advisors are already reducing access to retirement planning services to comply with the current grandfathering provision.

FINRA Rule 2111 includes the concept of a “hold” recommendation, in which a financial advisor recommends to a customer that they maintain an existing position. Such a recommendation is subject to the FINRA suitability standard, but since it does not involve a purchase or sale of securities, it should not be considered fiduciary advice for these purposes. Many of our member firms advise us that if this is not the case, they may be required to send written contracts to all customers with existing securities positions and comply with the other provisions of the BICE. In cases where customers have small account balances, this creates an incentive for advisors to stop servicing existing accounts because the expense and potential liability that flows from the requirements of the BICE will render it uneconomical. Expanding the grandfathering provisions would help to reverse the harm being caused by investors, particularly those with small accounts that are too costly to continue servicing given the compliance costs and litigation risks.

#### A. Proposed Grandfathering to Protect Small Accounts

These problems can be avoided by adopting a true grandfathering provision for transactions entered into prior to the effective date of the new fiduciary definition has demonstratively harmed investors. Adding such a rule would help to reverse that harm, particularly with regard to investors with small accounts that are too costly to continue servicing given the compliance costs and litigation risks. In its decision not to exempt existing accounts – which did not involve fiduciary advice – the DOL believed that the number of firms that would abandon transaction-based compensation models would be “minimal”<sup>65</sup> and thus concluded that the advice gap predicted by industry would not materialize.<sup>66</sup> Thus, no exception was made for existing arrangements and the only grandfather provision requires use of the BICE and is so limited in scope and clarity that it is of limited utility.

Given that a significant number of firms and financial advisors are abandoning or curtailing transaction-based compensation practices and the disturbing increase in the number of orphaned accounts, it is clear that a substantial number of individuals and households are losing

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<sup>64</sup> Letter from Randel Johnson & David Hirschmann, U.S. Chamber of Commerce, to DOL Employee Benefits Security Administration (April 17, 2017) available at: <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB79/01295.pdf>.

<sup>65</sup> U.S. DOL, Regulating Advice Markets Definition of the Term “Fiduciary” Conflicts of Interest – Retirement Investment Advice Regulator Impact Analysis for Final Rule and Exemptions, p. 243 (April 2016) available at: <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf>.

<sup>66</sup> *Id.* at 243-44.

access to personal retirement planning services. A true grandfather rule would help curtail the problem of abandoned accounts without harming investors. Provisions of such a rule would include:

- Compensation paid in connection with transactions entered into before June 9, 2017 would not be considered the result of fiduciary investment advice;
- With regard to existing grandfathered accounts, additions to the asset allocation mix (new share classes, etc.) in and of themselves would not cause a loss of grandfather status;
- Any recommendation to make additional contributions to an existing account, without more, should be excluded from the definition of investment advice. Such conversations also should not affect the grandfather status of an existing account.

The grandfather rule would be set forth in a new exception to the definition of fiduciary investment advice. A proposed exception is included in Appendix 1 and we urge its adoption.

## **VII. Response to Remainder of General Questions in RFI**

As stated above, we believe the Fiduciary Rule's harmful effects can be eliminated, ensuring consumer access to retirement planning services by making the changes we suggest. Our prior discussion addressed many of the general questions posed in the RFI. We believe we addressed General Questions 2 through 6 and 10, 11, 13, 14, and 16 in our responses above. This section will address the general questions not addressed by our prior discussion.

### **A. Wholesale Shares, T-Shares, Fee-Based Annuities, and other Product Innovations**

Regarding General Questions 7, 8, and 9, we direct the DOL to Section 4 of the Oxford Economics study attached as Appendix 2 to this letter. Section 4 is titled "Market-Based Solutions Can Better Serve Investors" and contains data pertinent to clean shares, T-shares, fee-based annuities, and other potential product innovations.<sup>67</sup>

### **B. Additional Time Necessary**

As a preliminary matter, the interviews of FSI members conducted by Oxford indicate a need for more time for the industry to coordinate. Broker-dealers, product manufacturers, and service platform providers all need to be involved in developing and implementing product innovations. Once developed, additional time is necessary "for market solutions to develop, get implemented, and prove acceptable to customers." Even then, financial advisors need to be familiarized and trained on the products and how they will work to further investors' goals. As stated in the report, "the tight time frame imposed by the fiduciary rule severely restricts the ability of the industry to properly develop these emerging market solutions, particularly since the most promising solutions require some degree of industry standardization."<sup>68</sup> Still, the Oxford researchers found that despite the time challenges, the industry is working toward price standardization, although "the current rule allows neither the time nor structure to allow for this positive outcome."<sup>69</sup>

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<sup>67</sup> Oxford Economics, *supra* note 6 at 27.

<sup>68</sup> *Id.* at 27.

<sup>69</sup> *Id.* at 32

### C. T-Shares

Included in the product innovations currently in development are T-shares, the subject of General Questions 7 and 9. As stated in the report, the industry is exploring T-shares as one potential means to “standardize pricing on mutual fund purchases.” However, several challenges exist with T-shares. FSI members interviewed by Oxford expressed concern about the complexity of T-shares and felt some characteristics of T-shares are troublesome. “One important objection expressed is that lower up-front costs will lose its appeal when investors are charged higher fees during routine rebalancing of accounts; or for other investors who lose the benefit of reduced fees that results as a right of accumulation.”<sup>70</sup> As pointed out in the report, most of the FSI members interviewed by Oxford felt that “the limitations of T-shares are a result of the time pressure (created by the rule) to bring a new share class to market.”<sup>71</sup>

One FSI member described in the report as a “major broker-dealer” reported to Oxford that “a full conversion to T-shares will result in harm to just over 50% of their clients in commission mutual fund purchases.”<sup>72</sup> The FSI member conducted an internal review of current customer holdings in mutual funds and determined that “just over 50% of purchases were made at a breakpoint that resulted in lower loads than the 2.50% load on T-shares.”<sup>73</sup> Clearly more time is needed to not only develop T-shares but to determine if they are, in fact, adequate to address the conflicts of interest concerns of the DOL and if they will actually be beneficial to investors.

### D. Wholesale Shares

As outlined in the report, “to address some of the shortcomings identified during the development and testing of T-shares, Wholesale Shares (also known as Clean Shares) have begun to emerge as a new share class in mutual funds.”<sup>74</sup> Wholesale shares provide a standardized up-front cost but allow additional services to be layered on the initial cost. While promising, “one of the key challenges to Wholesale Shares is that broker-dealers will need to devise and implement new commission structures to replace revenue lost from product manufacturers,” namely 12(B)-1 fees, “which cover distribution, marketing, and service costs.”<sup>75</sup> While the report notes that currently “many broker-dealers lack the administrative or technological infrastructure to begin introducing a new fee structure, and until this infrastructure is properly developed there will be strenuous objection to losing (without replacement) revenue that is needed to cover service and maintenance expenses.”<sup>76</sup>

As is the case with T-shares, more time is necessary for the development and implementation of Wholesale Shares. That said, Oxford noted in their report that the Wholesale Shares “approach appears to have great promise for investors” and FSI members they interviewed expressed confidence that “with sufficient time” any challenges with regard to Wholesale Shares could be addressed.<sup>77</sup> So, while Wholesale Shares show much promise, as

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<sup>70</sup> *Id.* at 5.

<sup>71</sup> *Id.* at 31.

<sup>72</sup> *Id.* at 30.

<sup>73</sup> *Id.* at 30.

<sup>74</sup> *Id.* at 28.

<sup>75</sup> *Id.* at 27.

<sup>76</sup> *Id.* at 28.

<sup>77</sup> *Id.*

noted above regarding the current need for additional time, “the current rule provides neither the time frame nor structure to allow for this positive outcome.”<sup>78</sup>

#### E. Fee-Based Annuities

While fee-based annuities are being developed to address the issue of conflicts, they face the same challenges as T-shares and Clean Shares. Oxford noted in their report that “although [annuities] products are an important source of income for retirees, there is currently no easy way for investors to access these products because the fee-based annuity technology has yet to be installed on fee-based retirement platforms. Annuity manufacturers need additional time to install these products on distribution platforms before they can be offered to investors.”<sup>79</sup> The relevant portion of the study states:

Most broker-dealers interviewed report movement toward modified pricing structures in annuity products. The most common pricing structures generally involve level up-front commissions that are much lower than previously offered but coupled with the introduction of trailing fees. Pricing within each annuity product class is standardized to reflect such characteristics as investment, tax, and income objectives, as well as the age of the investor purchasing the annuity. Given the complexity of the underlying investment mix coupled within each annuity, and the fact that broker-dealers are dependent upon product manufacturers to provide the detailed cost information required to convert to new commission schedules, converting to a new standardized commission schedule is proving to be challenge for many firms. Adding to the challenge is the problem that many times the new level-fee structure results in higher lifetime commission costs for the investor relative to the larger one-time up-front commission charge previously common to these products.<sup>80</sup>

#### F. Other Product and Compensation Innovations

With regard to other potential product and compensation innovations, we direct the DOL to Section 4.2 of the attached Oxford report, which discusses ways in which the fiduciary rule may impact current market solutions with details on commission pricing, non-billable assets, and non-traded REITs.<sup>81</sup>

#### G. Principal Transactions

Regarding General Question 12, FSI defers to other commenters as most of our membership does not engage in principal transactions with sufficient frequency to identify this as a top priority concern with the Fiduciary and thus we cannot provide helpful information to the DOL on this topic. We defer to other commenters’ responses to this question.

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<sup>78</sup> *Id.* at 31.

<sup>79</sup> *Id.*

<sup>80</sup> *Id.* at 28.

<sup>81</sup> *Id.* at 29.

H. Bank Deposit Products, Insurance Intermediaries, and Independent Fiduciaries with Expertise

Regarding General Question 15, 17, and 18, FSI is unable to provide the requested information sought in this questions as the subject matter does not directly apply to our members. We defer to other commenters' responses to these questions.

**Conclusion**

While FSI supports the implementation of a uniform fiduciary standard of care applicable to all financial advisors providing personalized investment assistance to retail clients, we have significant concerns that the Fiduciary Rule will harm the very investors it hopes to protect by reducing investor access to retirement advice. We urge the DOL to adopt our recommended changes to the Fiduciary Rule to avoid these and other unintended negative consequences for investors. As discussed in our previous comments, we strongly support a further delay of the rule's implementation date to allow the DOL to conduct a detailed review of its negative impact and to allow for coordination between the DOL, SEC and FINRA to develop a single standard.<sup>82</sup>

We look forward to working collaboratively with the DOL during this process to ensure access to retirement products and services for all investors.

Thank you for considering FSI's comments. Should you have any questions, please contact me at (202) 803-6061.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "D. T. Bellaire". The signature is fluid and cursive, with a large initial "D" and "T" followed by "Bellaire".

David T. Bellaire, Esq.  
Executive Vice President & General Counsel

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<sup>82</sup> Letter from David T. Bellaire, Executive Vice President & General Counsel, Financial Services Institute, to DOL Employee Benefits Security Administration (July 7, 2017), available at: <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB82/00042.pdf>.

## Appendix 1

### Suggested Language for Additions to the Fiduciary Rule

#### A. Reasonable Compensation Guidance

##### **PTE 2016-01, New Sections VIII (r) and (s) [with conforming changes incorporated into other applicable PTEs]**

(r) With regard to a Financial Institution, “Reasonable Compensation” shall mean reasonable compensation within the meaning of ERISA section 408(b)(2) and Code section 4975(d)(2), solely with regard to fees paid to such Financial Institution or by such Financial Institution for distribution. For purposes of this exemption, compensation shall be deemed to be reasonable compensation if it meets an applicable fair and reasonable compensation standard. Notwithstanding the above, compensation that is in excess of the lowest price for a product or service is not necessarily in excess of Reasonable Compensation.

(s) An “applicable fair and reasonable compensation standard” with regard to any financial institution or advisor shall mean any of the following standards to the extent such financial institution or advisor is subject to enforcement of such standard by an appropriate regulatory body:

- (i) FINRA Rule 2121 regarding fairness standards for markups and commissions charged by member firms for securities transactions;
- (ii) FINRA Rule 2310 regarding fair and reasonable standards for compensation (including non-cash compensation) for member firms participating in an offering of direct participation program securities;
- (iii) FINRA Rule 2341 regarding fair and reasonable standards for compensation (including non-cash compensation) for member firms participating in an offering of securities of mutual fund and certain other investment companies;
- (iv) Any fair and reasonable compensation rules adopted by the SEC under the Advisers Act;
- (v) Any state insurance regulator’s approval of the terms and costs of an annuity contract under standards requiring an assessment of whether the contract’s provisions are fair and reasonable.

#### **Procedural Prudence Guidance**

This [guidance] section sets forth optional means for satisfying the reasonable compensation standard described in Section IV above. This section does not establish minimum requirements or the exclusive means for demonstrating that compensation is reasonable.

For purposes of this exemption, the compensation to be paid or received by a Financial Institution shall be deemed to be Reasonable Compensation if the Financial Institution, at least annually, reasonably (i) surveys from publicly available information the range of compensation for similar

services paid in the market; and (ii) determines that the compensation to be received by the Financial Institution and the Advisor is within the range of market compensation.

## **B. Streamlined Exemption for Fiduciary Advisors**

### **PTE 2016-01, New Section II(j)**

(j) *Fiduciary advisors.* Sections II(a), (b), (c)(1), (d), (e), (f), (g), and V do not apply to recommendations by Financial Institutions and Advisors if the Advisor, in providing services to the Retirement Investor, is subject to a fiduciary standard under applicable federal or state law. For such investment advice, relief under the exemption is conditioned upon the Advisor and Financial Institution complying with Section II(c)(2) and (3) and Section III. [This proposed language presupposes a revision of Section III as suggested in this letter.]

## **C. Streamlined Exemption for Rollover Advice**

### **New PTE**

- I. *Covered Transactions.* The restrictions of ERISA section 406(a)(1)(D) and 406(b) and the sanctions imposed by Code section 4975(a) and (b), by reason of Code section 4975(c)(1)(D), (E) and (F), shall not apply with regard to compensation received by a Financial Institution or Advisor in connection with Rollover Advice provided to a Retirement Investor, provided that the conditions of Section II are met.
- II. *Conditions.*
  - A. Prior to or contemporaneous with the transaction, the Retirement Investor is provided with:
    - (1) a prominent statement making clear that fiduciary investment advice is not being provided; and
    - (2) a written statement describing the following information:
      - i. The four typical options available upon termination of employment;
        1. Keep the money in the employer's plan, if permitted;
        2. Rollover the assets to the new employer's plan, if applicable and permitted;
        3. Rollover to an IRA; or
        4. Take a cash distribution from the plan.
      - ii. The relevant differences that should be considered in the rollover decision:
        1. The number and types of investment options;
        2. Costs and fees (an IRA account fees are typically higher than those in plans);
        3. The levels and types of services;
        4. Protection from creditors.
        5. Availability of loans

6. In the case of a rollover to an IRA, relevant tax law differences relevant to the Retirement Investor (e.g., required minimum distributions, early distribution rules, rollover restrictions)
  - iii. The financial professional may be conflicted in its advice because he or she only gets paid if the participant chooses to rollover.
- B. If the rollover is to an IRA, prior to or contemporaneous with the transaction, the Retirement Investor is provided with a copy of the IRA's Disclosure Statement described in 26 U.S.C. § 1.408-6.

*III. Definitions.*

- A. "Advisor" shall have the same meaning as in section VIII(a) of Prohibited Transaction Exemption 2016-01.
- B. "Financial Institution" shall have the same meaning as in section VIII(e) of Prohibited Transaction Exemption 2016-01.
- C. "Retirement Investor" shall have the same meaning as in section VIII(o) of Prohibited Transaction Exemption 2016-01.
- D. "Rollover Advice" shall mean a recommendation to rollover all or part of a Retirement Investor's account balance from an employee pension benefit plan (as defined in ERISA section 3(2)) to another employee pension benefit plan or individual retirement account described in Code section 408(a) or 408(b). A recommendation regarding the allocation of assets among various options under an individual retirement account is not Rollover Advice covered by this exemption.

**D. Addition to Investment Education Exception**

**New Section 29 U.S.C. §2510.3-21(b)(2)(iv)(B)(10)**

(10) general information on rollovers that does not include a recommendation regarding the allocation of investments between specific investment alternatives under the IRA or new plan;

**E. Grandfather Rule**

**New Section 29 U.S.C. §2510.3-21(k)**

*(k) Preexisting Transactions.* (i) Notwithstanding anything in this section to the contrary, this section shall not apply to compensation paid in connection with any transaction occurring before June 9, 2017 (a "preexisting transaction").

(ii) Compensation paid in connection with (A) the addition, deletion or substitution of investment alternatives to an investment account established before June 9, 2017, without a separate recommendation to purchase, sell or hold a specific investment alternative, and/or (b)

additional contributions made to an investment account established before June 9, 2017, shall be considered to be paid in connection with a preexisting transaction for purposes of paragraph (i).

## **Appendix 2**

**See the attached**

**Oxford Economics: Encouraging Market Alternatives to the Fiduciary Rule (August 7, 2017)**



OXFORD  
ECONOMICS

# ENCOURAGING MARKET ALTERNATIVES TO THE FIDUCIARY RULE

AUGUST 7, 2017

## **Oxford Economics**

Oxford Economics was founded in 1981 as a commercial venture with Oxford University's business college to provide economic forecasting and modeling to UK companies and financial institutions expanding abroad. Since then, we have become one of the world's foremost independent global advisory firms, providing reports, forecasts, and analytical tools on 200 countries, 100 industrial sectors, and over 3,000 cities. Our best-of-class global economic and industry models and analytical tools give us an unparalleled ability to forecast external market trends and assess their economic, social and business impact.

Headquartered in Oxford, England, with regional centers in London, New York, and Singapore, Oxford Economics has offices across the globe in Belfast, Chicago, Dubai, Miami, Milan, Paris, Philadelphia, San Francisco, and Washington DC. We employ over 250 full-time people, including more than 150 professional economists, industry experts, and business editors—one of the largest teams of macroeconomists and thought leadership specialists. Our global team is highly skilled in a full range of research techniques and thought leadership capabilities, from econometric modeling, scenario framing, and economic impact analysis to market surveys, case studies, expert panels, and web analytics. Underpinning our in-house expertise is a contributor network of over 500 economists, analysts, and journalists around the world.

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The Financial Services Institute (FSI) is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has successfully promoted a more responsible regulatory environment for more than 100 independent financial services firm members and their 160,000+ affiliated financial advisors—which comprise over 60% of all producing registered representatives. FSI effects change through involvement in FINRA governance as well as constructive engagement in the regulatory and legislative processes, working to create a healthier regulatory environment for its members so they can provide affordable, objective advice to hard-working Main Street Americans. For more information, please visit [financialservices.org](http://financialservices.org).

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## **August 2017**

All data shown in tables and charts is Oxford Economics' own data, except where otherwise stated and cited in footnotes.

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The modelling and results presented here are based on information provided by third parties, upon which Oxford Economics has relied in producing its report and forecasts in good faith. Any subsequent revision or update of those data will affect the assessments and projections shown.

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# EXECUTIVE SUMMARY

The Financial Services Institute (FSI) commissioned Oxford Economics to interview and survey its members regarding their experience in preparing to implement the Department of Labor’s (DOL) fiduciary rule. This report follows earlier studies completed by Oxford Economics during 2015 and 2017 in which one-time and recurring compliance costs to firms were estimated. As with the earlier engagements, Oxford Economics interviewed leading executives in the independent financial advisor community to update our understanding of the challenges confronting the community of independent financial services firms as it continues its efforts to implement the fiduciary rule.

One key finding in this report is that the rule is resulting in a reduction in product choice that was not explicitly included in the DOL’s cost-benefit analysis that accompanied the rule’s promulgation. For this and other reasons, in this report we reexamined the DOL’s earlier benefit calculations. We found that the DOL overstated the rule’s benefits by failing to account for the reduction in product choice, the value of retirement planning services, and a more general failure to link the purported benefits of the rule to any specific key provision of the rule. When combined with our calculations of actual costs incurred by firms in implementing the rule, there is considerable doubt about the potential for positive net benefit attributable to the rule at all.

Oxford Economics calculates implementation costs nearly 300% the DOL estimate; and that is before litigation impacts are considered.

## REGULATORY IMPACT ANALYSIS UNDERESTIMATES COSTS AND OVERSTATES BENEFITS

Building on our earlier work, we re-analyzed the Regulatory Impact Assessment, in which the DOL estimated the costs to industry and the purported benefits to investors of the rule. The DOL’s calculations estimated \$14 billion–\$16 billion in new costs from the rule, and \$33 billion–\$36 billion in gains to investors. However, our estimate of the rule’s costs, based on a detailed survey of firms we conducted in April 2017, finds that actual costs to broker-dealers are nearly three times the DOL’s estimates. Extrapolating to other affected entities, this would imply costs of \$39 billion–\$47 billion, an amount that already exceeds the DOL’s benefit estimates. Importantly, these costs do not include the costs from potential litigation, which the rule will almost certainly increase substantially.

Moreover, the DOL’s estimated benefit to investors that it expects will result from the rule are based on highly speculative assumptions applied to a small segment of retirement assets (front-end load mutual funds held in Individual Retirement Accounts). The estimated gains in this asset segment are based on assumptions derived from an analysis of an even smaller segment of assets: domestic equity mutual funds, where the DOL estimates a 59-basis point underperformance of broker-sold relative to direct-sold funds. For foreign equity funds, however, broker-sold funds overperform direct-sold funds. In the DOL’s own analysis, when both foreign and domestic funds are considered, the net underperformance is only 6-basis points, implying benefits only one-tenth DOL’s estimates.

Outside of front-end load mutual funds, the DOL asserts broad additional gains as a result of reduced conflicts of interest, but in fact, as our interviews with industry now confirm, a major impact of the rule is loss of access to a large array of investment products, with consequent losses to investors. Variable annuities, an important income-supplementing product favored by many retirement savers, are reportedly less available as a result of the rule. In another example, non-accredited investors (mid-sized portfolios) will likely have less opportunity to invest in non-traded products that are especially suitable for diversification from volatile financial markets. Additionally, and contrary to DOL predictions, our interviews confirm earlier claims that the rule is causing smaller investors to lose access to advising services, with consequent losses.

Finally, it's worth noting that the calculation of purported gains on front-end load mutual funds are entirely divorced from the specific provisions of the rule. While all parties agree that eliminating conflicts between advisors and clients is a good thing, these rules impose large costs by creating multiple standards of care, requiring large amounts of redundant and largely unproductive paperwork, and inviting litigation to settle disputes. These costs are expected to accelerate as the January 1, 2018 requirements become imminent.

#### **MARKET-BASED SOLUTIONS PRODUCE BETTER OUTCOMES**

During this engagement, important insights were gained about possible market solutions that are evolving to address many of the challenges presented by the fiduciary rule. Many of those interviewed expressed frustration that the promise of these solutions is being curtailed by time constraints imposed by the rule. In addition, anti-trust concerns are preventing key industry participants from engaging in the collaborative dialogue that would facilitate the establishment of industry standards that best meet the demands of investors and retirement savers. The thoughtful adoption of market-tested industry standards will very likely result in more cost-effective approaches that better serve investors than what is allowed by the existing rule. Regulatory agencies can play a critical role in creating appropriate forums for industry participants to engage in constructive dialogue about the optimal characteristics that should be accepted as industry standard.

Innovative level pricing structures and means to replace important third-party revenue sources are two important examples of emerging industry solutions that would benefit from a more careful consideration of what constitutes the most appropriate industry standard than what is allowed by the constraints of the current rule. Many of these innovations would, if allowed to properly mature, likely reduce costs and improve access to retirement services for investors.

- Level pricing: In major product categories, such as mutual funds, annuities, and REITS, there is a clear movement toward pricing that is more level across specific product classes. In general, these level pricing structures combine a smaller upfront fee with trailing commissions. Most firms interviewed were not philosophically opposed to level pricing schemes. There was widespread concern, however, that under the existing time constraints many of the solutions emerging either inadvertently harm some

Regulatory agencies can play a critical role in promoting constructive dialogue to produce better market-solutions.

investors (e.g., T-Shares) or are currently offered by too few product manufacturers to allow widespread distribution on service platforms (e.g., clean shares).

- Revenue Shifting: Firms are exploring ways to replace third-party revenue sources with more direct and transparent charges for service and expense reimbursement. Many of those interviewed expressed support for this trend but also pointed out that in many cases their firms currently lack the administrative and technological capacity to layer new service charges over other charges imposed by product manufacturers and service platform providers. An orderly transformation of this pricing and revenue structure will take more time than is allowed by the rule.

In general, those we interviewed expressed confidence that these and other innovations would achieve the DOL's goals at substantially less cost and without restricting access to retirement planning services and products. However, these efforts will likely be truncated before reaching their full potential without more time than what is allowed by the rule.

Mutual fund manufacturers are having difficulty offering rule compliant product. One major broker-dealer reports that it now offers fewer than 30 mutual fund families down from more than 400 before the rule went into effect.

#### **REDUCED PRODUCT CHOICE**

Product choice is important because it allows an investor to create a portfolio that best reflects that person's unique financial situation, investment objectives, and risk profile. Many of those interviewed in our earlier engagements expressed their commitment to offering the broadest array of products possible. During this engagement, however, we gained new insight into how most of those interviewed were now limiting product choice in response to the rule. In general, this reduction in product choice stemmed from one or more of the following reasons:

- Data feeds: There are large fixed costs to establishing and maintaining the data feeds from product manufacturers and mutual fund families that are necessary for broker-dealers to provide information required by the rule to investors. As a result, most broker-dealers report that fewer product families will be available to their clients.
- Litigation risk: There is considerable concern over new legal risks created by the rule. Many firms reported movement toward a more homogenized product offering as a strategy for reducing variance in product performance within specific product classes. The wider range of products offered, the wider will be the difference in fees and performance. The rule is perceived to create too much opportunity for trial attorneys to exploit these differences in fees and performance through class action lawsuit. Therefore, many firms are carefully considering how much fee or expected performance variance they are willing to offer through varied product selection. As a result, products become homogenized and choice limited.
- Complexity of compliance: Many mutual fund manufacturers intend to offer "T-share class" or "clean share" mutual funds and a number of mutual fund manufacturers filed these new products with the Securities and

Exchange Commission (“SEC”). Unfortunately, the current offering of such funds is extremely limited resulting in retirement investors having few commissionable mutual fund options from which to choose. Specialized product manufacturers similarly report that the added complexity of offering non-standard products to investors (for example, non-traded REITs), is severely limiting the range of products created and available to retirement investors.

In the chapters that follow, we explore each of these findings in more detail. First, however, we present a brief overview of the rule and some of its key impacts.

# 1. INTRODUCTION

## 1.1 REPORT OVERVIEW

In June, 2017, the Department of Labor (DOL) published a Request for Information (RFI) regarding its review of its Fiduciary Duty Rule. To help it respond to this RFI, the Financial Services Institute (FSI) commissioned this study by Oxford Economics. Oxford Economics has previously examined and reported on various aspects of the fiduciary rule on behalf of the FSI.<sup>1</sup> This report builds on our earlier findings, and summarizes industry insights and opinions gleaned from over a dozen interviews conducted in recent months.<sup>2</sup>

This report will focus on the following themes:

- The DOL’s regulatory impact analysis (RIA)<sup>3</sup> underestimated the cost of implementing the rule.
- The DOL’s RIA significantly overstated the rule’s benefit; this overstatement results from a number of shortcomings in the RIA.
- Market-based solutions, spurred in part by the rule, are emerging that address the key objectives of the rule in a more cost-effective way but need more time for development and implementation.

These themes will be examined, respectively, in chapters 2, 3, and 4 of this report.

## 1.2 OVERVIEW OF KEY PROVISIONS OF THE FIDUCIARY RULE

The basic premise of the fiduciary rule is to reduce conflicts of interest between broker-dealers and investment advisors, and their investor-clients. While everyone agrees that avoiding conflicts of interest is a worthy goal in principle, and that some potential conflicts have existed, there is significant disagreement about how these are best addressed. An important theme of our recent interviews discussed in this report is that many of the conflicts of particular concern to the DOL are

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<sup>1</sup> Oxford Economics, August 2015. “Economic Consequences of the US Department of Labor’s Proposed New Fiduciary Standard.” [http://www.financialservices.org/uploadedFiles/FSI\\_Content/Advocacy\\_Action\\_Center/DOL/FSI-OE-Economic-Impact-Study.PDF](http://www.financialservices.org/uploadedFiles/FSI_Content/Advocacy_Action_Center/DOL/FSI-OE-Economic-Impact-Study.PDF).

Oxford Economics, April 2017. “The Fiduciary Rule Increases Costs and Decreases Choice.” [http://www.financialservices.org/uploadedFiles/FSI/Advocacy\\_Action\\_Center/The\\_Fiduciary\\_Rule\\_Increases\\_Costs\\_And\\_Decreases\\_Choice.pdf](http://www.financialservices.org/uploadedFiles/FSI/Advocacy_Action_Center/The_Fiduciary_Rule_Increases_Costs_And_Decreases_Choice.pdf).

<sup>2</sup> See appendix A on methodology.

<sup>3</sup> Regulatory Impact Analysis (RIA): DOL (April 2016). “Regulating Advice Markets: Definition of the Term ‘Fiduciary’ Conflicts of Interest—Retirement Investment Advice.” Regulatory impact analysis for final rule and exemptions. <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf>

being addressed by market mechanisms, which the DOL can help foster rather than attempt to circumvent through regulation.

In order to avoid conflicts of interest, the new rule generally prohibits, in the first instance,<sup>4</sup> transactions on behalf of a client in which an advisor or broker stands to receive differential compensation depending on whether a specific transaction occurs. While a blanket prohibition on such transactions might seem sensible at first blush, in fact such situations are nearly ubiquitous in the financial industry, and in many cases, are simply unavoidable. For example, any transaction in which brokers are compensated by commission on the amount transacted is prohibited under the new rule unless an exemption has been provided and all of the requirements met. To get around this, some financial advising firms are reorienting their business models to avoid commissioned transactions altogether, and instead shift to an assets-under-management (AUM) fee structure.<sup>5</sup>

However, AUM fees present challenges. For example, these fees are not in the best interest of many clients, especially so-called buy-and-hold investors, who do better to pay a single fee up-front and then accumulate earnings over the long term. If a consequence of the rule is that it deprived these investors the option to receive investment advice in a commissioned account, that would be contrary to these clients' best interests, and would be a perverse outcome. In addition, certain types of specialty or illiquid investments are extremely difficult to value on an ongoing basis, and thus do not lend themselves to asset-based-fee style accounts.<sup>6</sup> The loss of these products would limit diversification options and increase risk in investors' retirement portfolios. This is also contrary to investors' best interest and an undesirable outcome.

Because the DOL recognized that conflicts of interest were impossible to eliminate in their entirety, the rule provided exemptions to the general prohibition on transactions in which brokers or advisors had some level of conflict. The most significant exemption is the best-interest contract (BIC) exemption. The BIC allows an advisor to execute an otherwise prohibited transaction under the condition that a contract is executed between the advisor and client that discloses potential conflicts of interest, and states that the advisor is acting in the best interest of the client. Importantly, the provisions of the BIC exemption require that this contract be enforceable in state courts—i.e., that disputes arising under such contracts cannot be made subject to binding arbitration. This provision is referred to as a private right of action. Perhaps no provision of the new rule is as concerning to the industry as this one, which seems to invite class-action lawsuits and has raised fears of major and uncertain new litigation costs.<sup>7</sup> Concerns about litigation

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<sup>4</sup> i.e., with exceptions, discussed below.

<sup>5</sup> That is, the advisor's compensation is equal to a certain fixed share of the total amount invested, regardless of what financial instruments the assets are invested in or the frequency of transactions.

<sup>6</sup> Importantly, several of our interviewees note, for clients with a mixture of more and less liquid assets, it often makes most sense to concentrate such illiquid investments in retirement accounts, which are by their nature harder to access on short notice.

<sup>7</sup> FSI is involved in litigation to challenge the private right to action and other provisions of the rule.

expense has the potential to push retirement planning services out of the reach of many investors.

The new rule also requires a wide range of expanded disclosures to clients about compensation, as well as expanded record keeping. While those we interviewed were supportive of the value of disclosure in general, there was a widespread perception that investment clients are already inundated by disclosures in this heavily regulated industry, and that the new paperwork will do little to better inform clients while adding significant costs (that must ultimately be passed on to clients). These costs will also impact investor access to retirement planning services, creating another undesirable result of the rule.

A few other specific provisions of the rule were also singled out by interviewees. For example, the rule places a special burden on advisors executing a rollover of funds from a client's existing retirement account (e.g., a 401(K) from a previous employer) into a new retirement account. In such cases, an advisor is required to specifically review with the client the fee structures of the two accounts; notwithstanding that obtaining precise information about a client's existing account held with a different advisor can be difficult or impossible. This challenge has the potential to deprive investors of much needed education about their retirement account options when changing employers.

It is important to note that the new rule, implemented by the DOL under the Employee Retirement Income Security Act (ERISA), applies only to retirement accounts. This fact creates a seam in the standards of care between different accounts of a single individual working with a single advisor, i.e., between the individual's retirement and non-retirement accounts. Many of those interviewed suggested that investors would be better served by a single standard of care implemented by the Securities and Exchange Commission in conjunction with the Financial Industry Regulatory Authority, which are each thought to have more expertise on these matters and thus better able to craft and enforce more thoughtful and less costly rules.

### **1.2.1 One Key Impact of the Rule: Reduced Product Choice**

This subsection describes the implementation challenges presented by some of the previously discussed provisions of the rule. Our earlier report,<sup>8</sup> written in 2015 when a draft version of the rule had just been proposed, attempted to predict what would be some of the most significant impacts of the rule. Now that the rule is already partially in effect, and is scheduled to take full effect at the start of 2018, the likely impacts are much better understood.

One important conclusion reached by virtually all of those we interviewed is that firms are reducing product choice in order to comply with the fiduciary rule. The more product choice, and the more varied the choice within product family, the greater the risk in litigation as a result of the rule. It is difficult to overstate how

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<sup>8</sup> Oxford Economics (August 2015). "Economic Consequences of the US Department of Labor's Proposed New Fiduciary Standard." Report produced for the Financial Services Institute.

significantly this result—the limitation of product choice—is at fundamental odds with the core mission of the community of independent financial services firms and the needs of retirement investors.

Firms interviewed all expressed concern that the opportunity for class-action lawsuits created by the private right of action was narrowing the availability of many products. An oversimplified description of concern is that more options (especially those with liquidity, price or performance characteristics) invited class action lawsuits and therefore the solution is to standardize fewer products that are less differentiated and more homogenized. While many firms remain committed to providing as much product choice as possible, most firms could point to specific examples of how choice has been reduced. For example:

- One firm indicated that it had already reduced the number of mutual fund families offered from 185 to 30. Many of the smaller families dropped were precisely those with the most innovative managers and approaches to investing, but because of scale, these smaller emerging funds could no longer be offered.
- Another firm eliminated all commissionable alternative investments in qualified accounts. This resulted in a 50% reduction in the number of real estate products offered.

### **1.2.2 Another Rule Impact: Complex Paperwork for the Investor**

The sheer complexity of new transaction-specific process documentation imposes large costs on the advisor with questionable benefit to the client. Per-transaction process documentation with the full disclosures required by the fiduciary rule were estimated by our interviews to require up to 12 pages of documentation and take anywhere from 20 minutes to two hours to complete. Furthermore, many argued that the actual content of this documentation often varied little from transaction to transaction and that an annual or semi-annual summary statement could provide the same information in a much more cost-effective manner.

It was further noted that this extensive documentation at the time of each transaction is fundamentally at odds with the way in which most investors typically interact with their advisor. Most investors initiate discussions with their advisor over the phone; and the purpose of the call is often to initiate a transaction that involves timely execution. That is often not the right environment or context in which to begin complex legally oriented paperwork discussions and review. By analogy, one might consider how worthwhile (if at all) it is to receive complex service agreements each time one wishes to upgrade software on a mobile device and whether similarly lengthy legal documents are the best way to transmit important investment advice between an advisor and investor. Effective communication that properly balances frequency of disclosure and the content of what is disclosed would serve investor interests better than comprehensive, detailed disclosures that are provided in forms and at times that do not help inform investment strategy.

### 1.3 REGULATORY IMPACT ANALYSIS

Like other economically significant regulations, the Regulatory Impact Analysis (RIA) includes an analysis of costs and benefits. Oxford Economics reviewed the reported costs and benefits associated with the draft rules in August of 2015.<sup>9</sup> Following that, and in part in response to our and others' critiques of the draft rule, the DOL released revised cost and benefit calculations with the final rule in April 2016.<sup>10</sup> Overall, the DOL estimates costs of the rule to be between \$12 billion and \$31 billion over 10 years, depending on various assumptions.<sup>11</sup> Our review of the DOL's cost estimates focuses on their cost estimates (based on our earlier work) and uses their "medium reduction scenario,"<sup>12</sup> the overall estimates for which are \$14-\$16 billion in costs over 10 years, depending on the time discount rate used. Of these, approximately 31%, or \$4-\$5 billion, reflects costs to broker-dealers.

In late March 2017, Oxford Economics performed a survey of FSI members to estimate cost implications of the rule on BDs, the results of which are presented in section 2 below.<sup>13</sup> We find total 10-year BD costs of roughly \$12 billion-\$14 billion, or nearly three times the DOL estimate. If this rate of underestimate were extrapolated to the full DOL cost estimates, this would imply total 10-year costs of the rule of roughly \$39 billion-\$47 billion.

**In comparison, the DOL estimates that the total 10-year benefits of the rule are roughly \$33 billion-\$36 billion. Thus, estimated costs already exceed the DOL's benefits estimate.**

The DOL's benefit calculations are reviewed in section 3. Fundamentally, the DOL only considers gains from increased returns on front-end-load mutual funds held in IRA accounts—roughly 12% of IRA assets. These calculated gains are subject to a great deal of uncertainty based on underlying assumptions of the underperformance of broker-sold funds, as well as the effectiveness of the rule in correcting this underperformance. The DOL asserts broader gains to investors outside the universe of front-end-load mutual funds in IRA accounts, but given the rule's broad curtailment of investor access to a variety of assets, and loss of access to retirement planning services by many low-net-worth investors, there are good reasons to doubt this assertion. Importantly, there is a lack of direct connection between the benefits calculations and the specific provisions of the rule. Emerging market-based solutions will likely be able to achieve many of the goals of the fiduciary rule at dramatically lower cost. Government regulators, like the DOL and the SEC, do have a role to play in fostering such innovation, and facilitating coordination of leveling of compensation across the industry, a point further discussed in Chapter 4.

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<sup>9</sup> See footnote 1.

<sup>10</sup> This CBA is presented in the rule's RIA.

<sup>11</sup> See table 5-13 of the RIA, page 249.

<sup>12</sup> This refers to a medium reduction in burden/cost relative to the original 2015 notice of proposed rulemaking.

<sup>13</sup> Although small additional extrapolations have been added, section 2 is largely identical to our April 2017 report.

## 2. COST ESTIMATES

In late March of 2017, Oxford Economics, working with FSI, conducted a survey of FSI members to estimate independent financial services firms' costs of compliance with the Fiduciary Rule.<sup>14</sup> Because the Fiduciary Rule had been scheduled since 2016 to go into effect on April 10, 2017, firms had already incurred a great deal of the expense related to one-time start-up costs, and were in a good position to estimate recurring annual costs.<sup>15</sup>

Overall, our results indicate that as reported in the 2016 RIA, broker dealer startup costs have been 1.7 times the DOL's estimate, and recurring costs are expected to be 3.5 times the DOL's estimate, with total 10-year costs exceeding DOL estimates by nearly 2.9 times. Extrapolating from these underestimates of costs to BDs to all the rules costs, implies a total cost figure of roughly \$39 billion—\$47 billion.

It is important to note that the cost estimates here generally do not include any estimate of expected litigation costs, which firms still report being unable to estimate reliably. An analysis by the American Action Forum suggests that firms involved in litigation as a result of the rule could face annual costs of up to \$150 million.<sup>16</sup> Similarly, Morningstar has estimated that class-action settlements as a result of the rule will cost the industry an average of \$70-\$150 million per year<sup>17</sup>. While this still leaves the fundamental question of how many firms will end up facing litigation uncertain, it does help establish the scale of potential impacts (which are absent from the DOL as well as our own cost calculations).

### 2.1 TOTAL COSTS

Firms in our survey were asked to estimate:

- Start-up costs already incurred
- Remaining start-up costs, assuming the rule goes into effect
- Recurring annual costs, assuming the rule goes into effect

Oxford Economics estimates that actual one-time startup costs to broker-dealers will be 1.7 times the DOL estimate. Recurring costs will be 3.5 times the DOL estimate and total costs 2.9 times greater.

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<sup>14</sup> This section is largely taken from our April 2017 report and is based on the survey we conducted for that work, which is described further in Appendix A. Section 2.3.1 has been added.

<sup>15</sup> Much of the rule ultimately did go into effect, following a delay, on June 9, 2017. Some disclosure requirements have long been scheduled to take effect at the start of 2018, while firms report that the DOL is providing some flexibility on other requirements for which compliance systems are still being developed.

<sup>16</sup> American Action Forum (April 10, 2017). "The Consequences of the Fiduciary Rule".

[www.americanactionforum.org/research/consequences-fiduciary-rule-consumers](http://www.americanactionforum.org/research/consequences-fiduciary-rule-consumers).

<sup>17</sup> Morningstar. Financial Services Observer (February, 2017). "Weighing the Strategic Tradeoffs of the U.S. Department of Labor's Fiduciary Rule."

Fig. 1: below summarizes average total costs across these three categories by size of the responding firm.<sup>18</sup> These survey responses were then extrapolated out to the full universe of FSI member firms, and then to the industry at large.

At the time of the survey, it was estimated that BDs had already incurred nearly half of the overall implementation costs, which were estimated at \$394 million in total for FSI members. Ongoing costs were estimated at an additional \$230 million per year for FSI members.

**Fig. 1: Summary of total cost estimates**

	Small BDs	Medium BDs	Large BDs	All BDs
Revenues	\$0-50 m	\$50 m–\$500 m	\$500 m+	
Share of FSI firms responding to survey	12%	9%	27%	12%
<b>Total costs per firm</b>				
Total implementation costs	\$911,000	\$3,787,000	\$13,105,000	\$3,619,000
Costs incurred	\$367,000	\$1,472,000	\$8,354,000	\$1,741,000
Remaining implementation costs	\$544,000	\$2,315,000	\$4,751,000	\$1,878,000
Recurring annual costs	\$344,000	\$2,407,000	\$7,375,000	\$2,113,000
<b>FSI-member estimated costs</b>				
FSI members	42	56	11	109
Total implementation costs	\$38,262,000	\$212,072,000	\$144,155,000	\$394,489,000
Costs incurred	\$15,414,000	\$82,432,000	\$91,894,000	\$189,740,000
Remaining implementation costs	\$22,848,000	\$129,640,000	\$52,261,000	\$204,749,000
Recurring annual costs	\$14,448,000	\$134,792,000	\$81,125,000	\$230,365,000
<b>Industry estimated costs</b>				
Industry size (from DOL)	2,320	147	42	2,509
Total implementation costs	\$2,113,520,000	\$556,689,000	\$550,410,000	\$3,220,619,000
Costs incurred	\$851,440,000	\$216,384,000	\$350,868,000	\$1,418,692,000
Remaining implementation costs	\$1,262,080,000	\$340,305,000	\$199,542,000	\$1,801,927,000
Recurring annual costs	\$798,080,000	\$353,829,000	\$309,750,000	\$1,461,659,000

Source: Oxford Economics

## 2.2 COST CATEGORIES

In addition to total costs, firms in our survey were asked to break their spend into 16 detailed categories of cost (see Fig. 2: for a description of the categories). This

<sup>18</sup> Total estimated costs for the broker-dealer industry are based on the breakdown of number of firms by size category in the DOL Regulatory Impact Analysis, counting only BDs affected by the new rules (those providing retirement accounts). It's worth noting that our current firm size definitions, based on revenues, do not precisely match DOL's firm size definitions, which are based on capital. This may be partly responsible for our higher ratio, compared to DOL's estimates, of costs for medium-sized firms than for small or large firms; however, our cost estimates are still significantly higher for all three size classes of firms. Only one of the medium-sized firms in our sample had revenues between \$250 million and \$500 million.

section explores the categories of both start-up and recurring costs. Detailed tables of these costs can be found in Appendix B.

**Fig. 2: Description of cost categories**

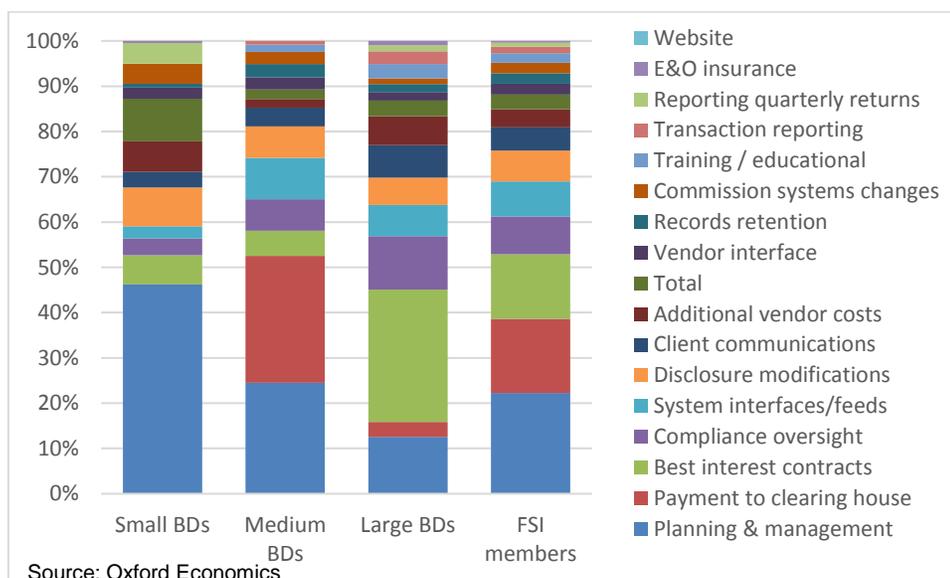
Cost category	Description
Additional vendor costs	Additional vendor costs (not hardware related)
Best-interest contracts	Best-interest contract implementation and monitoring
Client communications	Client communication letters (preparation, mailing, postage)
Commission systems changes	Commission systems changes or upgrades
Compliance oversight	Supervisory/compliance oversight modifications (typically more compliance officers)
Disclosure modifications	Disclosure modifications (website, forms, BIC contracts, advisory contracts, 12(B)-1 fee disclosures)
E&O insurance	E&O insurance premiums (changes anticipated in response to heightened risks)
Payment to clearing house	Change in payment to clearing house/platform, if applicable
Planning & management	Planning and project management (management and staff time spent preparing)
Records retention	Changing records retention standards to comply with rule requirements
Reporting quarterly returns	Calculation and reporting of quarterly returns
System interfaces/feeds	Newly required system interfaces (external/internal feeds) for historic/performance data
Training/educational	Training/educational materials (for use by internal staff)
Transaction reporting	Transaction reporting costs
Vendor interface	Modifications to vendor interface
Website	Website (public view for direct/indirect payouts)
Other	Other issues mentioned by firms such as: legal, additional staff, outside counsel consultation, loss of revenue from AAM contract renegotiation to an annual platform fee, DOL/BIC Compliance Officer, additional operations and supervision resources to process FIAs, orphaned account advisor, level fee repricing, operational review & processing

### 2.2.1 Start-up costs

Fig. 3: provides a detailed examination of the types of start-up costs firms have incurred or expect to incur related to the final rule. An examination of Fig. 3: reveals that for the group as a whole, over 20% of the expense incurred was in planning and management. These survey results are consistent with what was reported during the interviews, wherein firms generally reported that large task forces were established within each company to comprehensively plan for the rule's implementation.

Since the rule was proposed, most firms reported that they have had little to no time to invest in any initiative at the corporate level other than compliance efforts associated with the final rule.

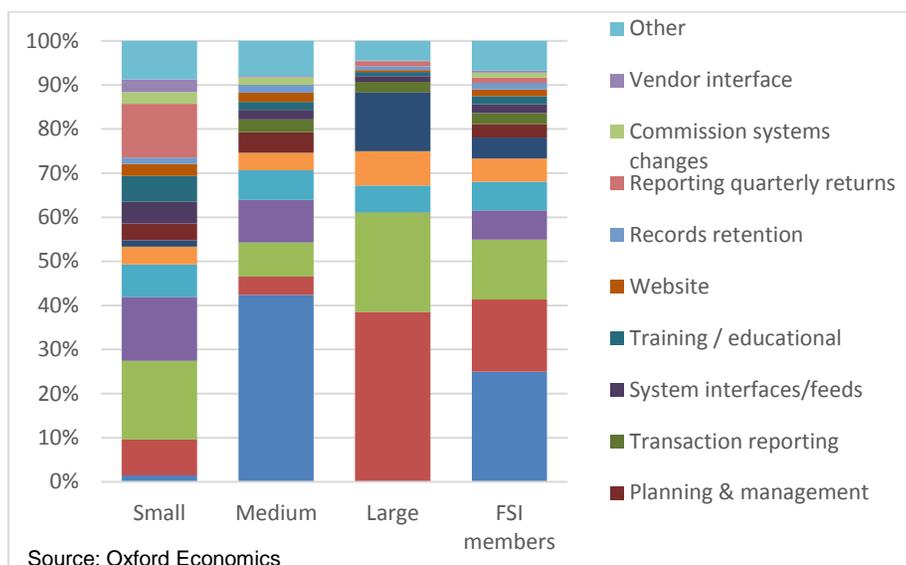
**Fig. 3: Detailed breakout of start-up costs**



### 2.2.2 Recurring costs

Firms participating in interviews and surveys had good insight into most of their expected recurring costs. We now have reliable estimates for the cost of data-feed interfaces needed from product manufacturers and fund families, the number of additional compliance and regulatory officers that will be hired, and the cost of maintaining a BIC-compliant website. One important expense category that is still in flux is the payment relationship between the broker-dealer community and the clearing platforms that service their accounts. In our discussions with the broker-dealers it was reported that one major platform provider was negotiating pricing plans but that given the uncertain future of the rule, in most cases these negotiations are still ongoing. Other firms using a different platform provider described being offered a wide range of compliance solutions. Once the rule is implemented, firms will select those solutions that are most suitable for their compliance and client needs. That process also remained unresolved. Different firms appear to be basing survey responses to this question either by projecting current payments going forward or by anticipating that fundamentally new pricing would be in place.

**Fig. 4: Detailed breakout of recurring costs**



### 2.3 COMPARISON WITH PAST ESTIMATES

A major focus of our 2015 report, like the current report, was to provide estimates of the anticipated costs of complying with the proposed DOL rule. When the prior estimate was calculated, however, there was uncertainty about the precise structure of the final rule. Firms now have substantially more knowledge about the rule’s requirements, compliance strategies, and compliance costs.

Fig. 5: below reviews multiple estimates of firm start-up and recurring costs for small, medium, and large BD firms. In the original 2015 RIA for the conflict of interest rule, the DOL estimated start-up costs of BD firms to vary between \$53,000 and \$1.1 million, depending on firm size. The DOL also provided a “high” estimate between \$242,000 and \$5 million, which it considered an overestimate. In our 2015 report, based on surveys and interviews, we estimated start-up compliance costs would be between \$1.1 million and \$16.3 million depending on firm size, roughly 20 times the DOL’s preferred estimate in aggregate. In its 2016 revised RIA, the DOL presented updated start-up cost estimates based, in part, on the estimates in our 2015 report.

However, the DOL asserted that, in response to comments, it had simplified and clarified the rule, resulting in cost reductions relative to our 2015 estimates. Based on its view of the degree of simplification, the DOL concluded in its 2016 RIA that start-up costs would vary between \$508,000 and \$6.7 million per BD firm.<sup>19</sup>

<sup>19</sup> <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf>, see section 5.3, especially table 5-9. Several cost estimates are presented in that section; we focus here on the “FSI medium reduction scenario” estimates. Note that DOL updated

**Fig. 5: Comparison of cost estimates**

				Total BD industry
	Small BD	Medium BD	Large BD	
Industry size (DOL)	2,320	147	42	2,509
<b>Per-firm start-up costs</b>				
DOL original estimates (Apr 2015)	\$53,000	\$145,000	\$1,091,000	\$190,097,000
DOL "high" estimates (Apr 2015)	\$242,000	\$663,000	\$5,000,000	\$868,901,000
OE/FSI 2015 report (Aug 2015)	\$1,118,000	\$3,350,000	\$16,266,000	\$3,769,382,000
DOL adjusted estimates (Apr 2016)	\$556,301	\$1,777,688	\$7,366,036	\$1,861,311,968
Current estimates (Apr 2017)	\$911,000	\$3,787,000	\$13,105,000	\$3,220,619,000
Ratio of current estimate to 2015 DOL estimate	17.2	26.1	12.0	16.9
Ratio of current estimate to 2016 DOL estimate	1.6	2.1	1.8	1.7
<b>Per-firm recurring costs</b>				
DOL original estimates (Apr 2015)	\$21,000	\$58,000	\$436,000	\$75,558,000
DOL "high" estimates (Apr 2015)	\$97,000	\$265,000	\$2,000,000	\$347,995,000
DOL adjusted estimates (Apr 2016)				\$413,000,000
Current estimates (Apr 2017)	\$344,000	\$2,407,000	\$7,375,000	\$1,461,659,000
Ratio of current estimate to 2015 DOL estimate	16.4	41.5	16.9	19.3
Ratio of current estimate to 2016 DOL estimate				3.5

Source: Oxford Economics and DOL Regulatory Impact Analyses

Whether because the DOL's 2016 revisions to their 2015 proposed rule was not as effective at cost reduction as it thought, or because our original cost estimates were too low, the current estimates of total start-up costs are roughly 1.7 times the DOL's (revised) 2016 estimates for the industry.

Because the rule and the associated costs were so poorly understood at that time, our 2015 report did not estimate recurring costs, except by scaling up the DOL estimates by the ratio of our start-up cost estimates to the DOL's start-up cost estimates. The DOL's revised RIA also did not provide a detailed breakout of recurring costs by size category, but estimated overall industry recurring costs at \$413 million, about 5.5 times its 2015 estimate. Compared to this revised estimate, however, our result of nearly \$1.5 billion in annual recurring costs for the BD industry is roughly 3.5 times higher than the DOL's estimate.

Based on these results for start-up and recurring costs, we calculate the total 10-year costs of the rule to the broker-dealer industry to be approximately \$14.2 billion using a 3% discount rate, or roughly \$11.9 billion using a 7% discount rate. These

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its number of affected BDs slightly between the 2015 and the 2016 RIAs. In this table, we apply the new number of BDs to the old cost estimates, which accounts for the small differences with past total figures—costs per BD are identical.

estimates are nearly three times the DOL's comparable cost estimates for BD costs (see Fig. 6:).<sup>20</sup>

**Fig. 6: 10-year discounted costs of rule on Broker-Dealers**

	10-year discounted costs (\$ millions)	
	3% discount	7% discount
DOL adjusted estimates (Apr 2016)	\$4,930	\$4,255
Current estimates (Apr 2017)	\$14,176	\$11,910
Ratio of current estimate to 2016 DOL estimate	2.9	2.8

Source: Oxford Economics

### 2.3.1 Extrapolating beyond broker-dealers

Oxford Economics has only generated independent cost estimates of the Fiduciary Rule on BDs, based on our survey of independent financial services firms. However, in the RIA, the DOL also identifies costs for six other cost categories under the rule.<sup>21</sup> While our basis for estimating costs in these categories is slim, we can provide a rough estimate by assuming the DOL underestimated costs in these categories by a similar magnitude to its cost underestimates for BDs, i.e., by 2.8–2.9 times, as shown in Fig. 6: Fig. 7: below presents such an approximation, showing 10-year costs of the rule between \$39 billion and \$47 billion.

**Fig. 7: Overall implied costs using BD cost ratios**

Cost categories (DOL RIA figure 5-12)	10-year discounted costs (\$ millions)			
	DOL figures (Apr 2016)		Implied figures based on BD cost ratios	
	3% discount	7% discount	3% discount	7% discount
Broker-dealers	\$4,930	\$4,255	\$14,176	\$11,910
Registered Investment Advisor firms using exemptions	\$5,369	\$4,637	\$15,570	\$12,984
Insurers	\$1,304	\$1,124	\$3,782	\$3,147
E&O Insurance	\$620	\$510	\$1,798	\$1,428
Registered Investment Advisor costs	\$151	\$135	\$438	\$378
Other service provider costs	\$57	\$50	\$165	\$140
Other Paperwork Reduction Act costs	\$3,713	\$3,058	\$10,768	\$8,562
<b>Total</b>	<b>\$16,143</b>	<b>\$13,769</b>	<b>\$46,697</b>	<b>\$38,549</b>

<sup>20</sup> Ibid, table 5-12. We follow here the DOL convention of assuming start-up costs come in as a lump sum at the end of year 1, and recurring costs are incurred once a year at the end of year 2 through the end of year 10.

<sup>21</sup> See figures 5-12 and 5-13 of the RIA, p. 248-249, and accompanying text for a description of these categories. For the first three rows in this table, as for our estimates above, we use the “FSI” estimates—i.e., those the DOL based on our 2015 work—under the “medium reduction scenario”. The costs in the last four rows do not have a similar breakout, but we continue to use the cost ratios of 2.8 and 2.9 from Fig. 6:.

# 3. REVISITING THE BENEFIT CALCULATION

In its RIA, the DOL asserts that investors will experience savings across a wide variety of products in investment accounts as a result of the rule. However, the DOL does not consider that a major impact of the rule appears to be the curtailment of investor choice in many products.

Moreover, the DOL's quantitative analysis of the rule's benefits comes entirely from a single source, specifically, the purported improved returns on front-end load mutual funds held in IRAs.<sup>22</sup> Ultimately, the DOL estimates benefits of \$33 billion–\$36 billion in net present value terms over 10 years, with their main scenario (scenario 1) corresponding to the lower end of this range, \$32.5 billion.<sup>23</sup> The calculations underlying this claim are reviewed briefly in section 3.1 below, after which some of the weaknesses and omissions are discussed.

## 3.1 REVIEW OF THE DOL CALCULATIONS

This section presents a simplified version of the benefits calculations in the DOL RIA. The major difference between the calculations presented here and those in the RIA is that the latter makes complex assumptions about how much of the purported benefit in each year is reinvested and earns compounded interest through the end of the 10-year time horizon.<sup>24</sup>

The DOL's estimates of the benefits of the fiduciary rule are based entirely on purported underperformance of front-end-load mutual funds in IRA accounts. The fundamental assumption behind these calculations, which the DOL bases on a review of academic literature and its own analysis of Morningstar data,<sup>25</sup> is that for every 100 basis points<sup>26</sup> of front-end-loads paid to brokers, investors will experience a 45-basis-point reduction in annual returns as a result of conflicts of

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<sup>22</sup> The DOL's analysis is presented in appendix B of the RIA, pages 340-364.

<sup>23</sup> Net present value is a technique for aggregating the value in the present of a future stream of costs or benefits by discounting the value of future costs or benefits at an increasing rate the further in the future they come. In layman's terms, a dollar today is worth more than a dollar next year, which is worth more than a dollar in two years. Specifically, the DOL uses a 5.4% discount rate in its calculations.

<sup>24</sup> This is DOL's main scenario reflecting the impact of the Fiduciary Rule, and the one these calculations most closely reflect. Scenarios 2 and 3 make additional assumptions about lower advising fees as a result of the rule and a faster ramp-up of the rule's effects. Because over most of this period, the overall rates of return in both the baseline and the DOL's scenario 1 are quite close to the discount rate of 5.4%, the impact of these assumptions is quite minor. The results presented here are only 1% lower than DOL's own estimates.

<sup>25</sup> The academic review based on that in Burke, Jeremy et. al. (2015) "Impacts of Conflicts of Interest in the Financial Services Industry". Rand Labor & Population working paper WR-1076. DOL's review of the Morningstar data is on pages 340-343 of the RIA.

<sup>26</sup> A basis point is one one-hundredth of a percent.

interest that it expects the fiduciary rule to eliminate.<sup>27</sup> This assumption will be discussed further in section 3.2 below, but for now is taken as given.

Using data from the Investment Company Institute (ICI), the DOL projects that front-end load fees paid to brokers will decline from 124 basis points in 2017 to 93 basis points in 2026,<sup>28</sup> meaning that the annual cost from conflicted advice on newly purchased funds is projected to fall from 56 basis points to 42 basis points.<sup>29</sup> (See columns B and C of Fig. 8: below.) However, since investments are held for multiple years, the total effect of conflicts on investment returns is assumed to be a weighted average of conflict-generated underperformance from current and past years (column D).

This assumption on annual underperformance due to conflicts is then multiplied by estimates of the total amount of front-end-load mutual funds in IRA accounts. Based on data from Cerulli Associates,<sup>30</sup> the DOL estimates 2017 IRA assets at \$8.7 trillion, 2017 IRA mutual fund assets at \$3.8 trillion, and 2017 front-end-load IRA mutual fund assets at \$1.043 trillion, increasing to \$1.600 trillion in 2026 under the baseline projection (column E of Fig. 8:).

Column F of Fig. 8: shows the implied underperformance in current dollars, while column G presents this amount discounted to net present value.<sup>31</sup> The total of this column, \$32.1 billion, is slightly below the DOL estimate of \$32.5 billion in benefits over 10 years because, for this example, we disregard the impacts of compound interest.<sup>32</sup>

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<sup>27</sup> This is in addition to the direct cost of the fees themselves, which are not assumed to change in scenario 1, which is modeled here, but are assumed to be reduced under scenario 2.

<sup>28</sup> This is on the assumption that 81.4% of all front-end-load fees get paid to the broker; remaining fees go, for example, to the product sponsor. Total fees are projected to decline from 153 to 114 basis points over this period.

<sup>29</sup>  $56 = 0.45 * 124$ ;  $42 = 0.45 * 93$ .

<sup>30</sup> See page 343 of the RIA. The Cerulli Report is titled "Retirement Markets 2015." This report is also used for forecasts of future IRA assets in the DOL calculations.

<sup>31</sup> Similarly, to DOL, we assume returns are realized at the end of the year, and discounted to 2016.

<sup>32</sup> A philosophical argument could be raised as to whether it makes sense to assume compound investment returns on the benefits from the rule, but not to assume that the costs incurred by the rule will come out of funds that might otherwise have been saved and earned compound interest. However, because the future discounting rate of 5.4% is quite similar to the rate of return investors are assumed to earn, the overall impact of compound interest is small—here, it is the difference between the DOL's result of \$32.5 billion and our result of \$32.1 billion.

**Fig. 8: Summary of DOL benefit estimate calculations**

Year	Front-end-loads paid to brokers	Under-performance due to conflicts	Weighted average of current and past under-performance	Baseline front-end-load mutual fund assets	Implied under-performance	NPV Discounted under-performance
(A)	(B)	(C)	(D)	(E)	(F)	(G)
Units	Basis points	Basis points	Basis points	\$ billions	\$ billions	\$ billions
Source	Based on ICI data	DOL assumes = .45 * (B)	Weighted average of (C)	Cerulli Associates data	= (D) * (E)	(F) discounted at 5.4%
2017	124	56	9	\$1,043	\$1.0	\$0.9
2018	120	54	18	\$1,099	\$1.9	\$1.7
2019	117	52	25	\$1,157	\$2.9	\$2.4
2020	113	51	32	\$1,217	\$3.9	\$3.0
2021	109	49	38	\$1,278	\$4.8	\$3.5
2022	106	48	42	\$1,340	\$5.6	\$3.9
2023	102	46	45	\$1,404	\$6.3	\$4.2
2024	99	45	47	\$1,468	\$6.9	\$4.3
2025	96	43	47	\$1,533	\$7.2	\$4.3
2026	93	42	46	\$1,600	\$7.4	\$4.2
Total						\$32.1

To summarize Fig. 8., the DOL’s benefits calculations assume increased annual returns of 9–47 basis points (column D) as a result of the rule on \$1 trillion–\$1.6 trillion (column E) in front-end load mutual fund assets over a ten-year time frame, resulting in \$1 billion–\$7.4 billion in increased return per year (column F). In present discounted value terms, this sums to \$32.1 billion (column G). The DOL makes additional assumptions about compound interest that raises this number to \$32.5 billion. The DOL also presents some variations on this model, adjusting parameters such as the portion of funds withdrawn in a given year, yielding benefits of \$33 billion–\$36 billion over ten years.

### 3.2 ORIGIN OF UNDERPERFORMANCE ASSUMPTION

As noted above, the fundamental assumption of the DOL’s benefits calculations is that broker-sold front-end-load mutual funds annually underperform direct-sold mutual funds by 45 basis points for every 100 basis points of front-end-load, or roughly 50 basis points overall on average over the 10-year window. This assumption is in turn based on the DOL’s analysis of Morningstar data on fund

returns,<sup>33</sup> which found an overall underperformance of 59.4 basis points specifically for domestic equity mutual funds.<sup>34</sup>

Domestic equity mutual funds, however, do not represent all front-end load mutual funds, the universe to which these estimates are being applied. In fact, it is widely known that while broker-sold mutual funds are seen to underperform self-selected mutual funds when it comes to domestic equities, they typically overperform self-selected mutual funds when it comes to international equities. In the same table in which they present their estimate of 59.4 basis points underperformance looking only at domestic equity funds, the DOL presents an estimate of a 161.4 basis point overperformance of broker-sold foreign equity mutual funds, yielding an aggregated underperformance among asset-weighted domestic and foreign equity funds of only 6.0 basis funds, roughly one-tenth the headline number of 59.4 basis points they emphasize. This is highly consistent with the ICI's estimated underperformance of broker-sold funds across nearly all asset classes on an asset-weighted basis of 10-11 basis points.<sup>35</sup>

The DOL argues, in essence, that the 59-basis point underperformance of broker-sold domestic equity mutual funds is the true cost of conflicts of interest to investors, applicable to all front-end load mutual funds, including overperforming foreign equity funds. The 161-basis point overperformance they estimate on foreign equity mutual funds, then, is a net figure incorporating both losses from conflicts as well as unrelated gains—which must therefore total 220 basis points before conflict-related losses.<sup>36</sup> This questionable assumption seems to result in an overstatement of the benefit calculation. While it's possible that reducing conflicts of interest in the industry—either through something like the Fiduciary Rule or other mechanisms—might further increase the already significant overperformance of broker-sold international equity funds; it's also possible that loss of access to advisory services as a result of the rule (see section 3.4) will lead to greater investor losses on foreign equity funds.<sup>37</sup>

Including foreign as well as domestic mutual fund performance reduces the DOL's benefit calculations to one tenth it's reported amount.

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<sup>33</sup> Essentially, the work in this area uses aggregate (i.e., as opposed to account-level) data on various mutual funds' returns, total assets, loads, and distribution channel to measure performance on both an absolute and a risk-adjusted basis. Appendix A (p 330-339) of the RIA presents the DOL's own version of this analysis, and responds to (and largely rejects) criticisms from ICI on the assumptions in the 2015 NPRM RIA.

<sup>34</sup> See table A-7, p. 338 of the RIA. The assumption above of 45 basis points for every 100 basis points of front-end load fees is actually cited by the DOL to Christoffersen, Susan, Richard Evans, and David Musto. "What Do Consumers' Fund Flows Maximize? Evidence from Their Broker's Incentives." *Journal of Finance* 68 (2013): 201-235. Their own result of 59.4 basis points average underperformance for domestic equity funds is presented as consistent with this.

<sup>35</sup> ICI comment letter on DOL Fiduciary Rule (March 17, 2017).

[www.ici.org/pdf/17\\_ici\\_dol\\_fiduciary\\_applicability\\_ltr.pdf](https://www.ici.org/pdf/17_ici_dol_fiduciary_applicability_ltr.pdf), p. 14. These results are also roughly consistent with those in Reuter, Jonathan (2015). "Revisiting the Performance of Broker-Sold Mutual Funds." Working Paper.

<sup>36</sup> See, again, table A-7 on p. 338 of the RIA, as well as footnote 628 and related main body text on p. 337.

<sup>37</sup> On this general point, see also table 5 (p. 21) and accompanying text of ICI's April 17, 2017 comment letter. [https://www.ici.org/pdf/17\\_ici\\_dol\\_fiduciary\\_reexamination\\_ltr.pdf](https://www.ici.org/pdf/17_ici_dol_fiduciary_reexamination_ltr.pdf).

Taking the DOL's 6.0 basis point underperformance estimate in place of their 59.4 basis point one would scale down the DOL's benefits impacts to roughly one-tenth its reported value, or about \$3.3 billion, far lower even than the DOL's own estimate of the estimated cost of the rule (roughly \$13 billion–\$16 billion).<sup>38</sup>

Note also that, in addition to the possibility that the current underperformance of broker-sold funds is overestimated, there is also the possibility that the rule will be less successful than the DOL assumes at alleviating this underperformance. That is, if the rule is only half as successful as the DOL assumes at improving advisors' selection of mutual funds through reduced conflicts, its benefits will be only half what they otherwise would be.<sup>39</sup>

Importantly, the narrow focus on examining investment returns associated with a subset of total available mutual funds are sold to investors ignores completely other critical considerations important to investors such as annuitization (income), death benefits (estate planning), and correlation (or diversification) with other investments.

### **3.3 LITTLE CONNECTION BETWEEN RULE'S PROVISIONS AND BENEFIT CALCULATION**

At least as significant as the fundamental uncertainty described above in the magnitude of potential benefits, however, is the general lack of connection between the substantive elements of the rule and the benefits calculation justifying those elements. While the benefits calculations are entirely based on relatively subtle questions of mutual fund choice (i.e., that advisors will select funds with half a percentage point higher annual returns on average as a result of the rule), much of the rule is not tailored to achieving this outcome.

As previously noted, during our interviews it was made clear that the rule is having significant impacts on the availability of a wide range of investment choices, such as annuities, REITs, and Business Development Companies (BDCs), both inside and outside of retirement accounts. While the DOL broadly asserts that conflicts affect these investments as well, and therefore the new rule must only improve outcomes for investors, the reality is that many mainstream investors are losing access to these investment options, which are often high performing and have desirable properties relative to traditional mutual funds.<sup>40</sup> By focusing narrowly on

The rule is having a significant impact on limiting choice both in and out of retirement accounts for products such as annuities, REITs, and BDCs.

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<sup>38</sup> That is, if the assumed gains to benefits to investors in the DOL's benefits estimates were only one-tenth the DOL's current assumptions—reflecting the 6-basis point net underperformance of all broker-sold funds, rather than the 59-basis point underperformance just of domestic equity funds—then the DOL's total benefits number would be reduced from \$32.5 billion to \$3.3 billion.

<sup>39</sup> The DOL would of course point out that, in addition to the possibility that current underperformance is being overestimated, there is the possibility that it is being underestimated. This same possibility does not extend to uncertainty over the rule's effectiveness, which is capped at 100%.

<sup>40</sup> Non-traded assets have distinct advantages that are attractive to many investors. These include performance that is not generally (as) correlated to the volatile swings in financial markets or dedicated income streams and often (in the case of non-retirement accounts) provide significant tax benefit. Because, by definition, these products are not available on publicly traded markets, they are generally only available to retail investors through a financial advisor.

front-end-load mutual funds in its calculations, the DOL has assumed away effects on the rest of the retirement savings, and indeed the broader investment market.

Specific contentious provisions of the rule, such as the private right of action, are hard to justify based on the DOL's benefits calculations. It seems unlikely that an investor's dissatisfaction with an advisor's recommendation of a slightly underperforming mutual fund is most appropriately resolved through a class-action lawsuit. Moreover, while other elements of the rule, such as a leveling of fees and disclosures, may help achieve the outcome of improving fund selection by advisors, emerging market-based solutions to these problems (admittedly spurred in part by this rule) will likely prove to be a cheaper and more effective way to achieve these objectives (this is further discussed in Chapter 4).

### **3.4 THE VALUE OF FINANCIAL ADVICE**

From the beginning of the rule-making process, a central point of dispute over the fiduciary rule has been whether the DOL is properly valuing the retirement planning services that investors gain through a relationship with a financial advisor. In its RIA, for example, the DOL speaks approvingly of so-called "robo-advisors which use new technology to target clients using automated-advice solutions and human advisers through the process of setting up portfolios."<sup>41</sup> In fact, since the DOL first proposed the Fiduciary Rule, top providers of robo-advising have switched tacks, emphasizing more human assistance for sizable accounts.<sup>42</sup>

To many in the industry, the DOL has been dismissive of the human side of the financial advising industry when divorced from a robo-advisor. As many noted during our interviews, the main value of a financial advisor is not in chasing short-term gains of a few basis points of return in the market. Rather, the advisor's role is to inform strategy and options that help a client make appropriate asset-allocation decisions, ensure that clients are realistic about the amounts they need to save for retirement (and often coach clients to better implement these strategies). Even the most experienced investors can benefit from the advisor's encouragement to maintain well-considered investment and savings strategies even during periods of market volatility. This advice can often have consequences on retirement savings; for example, in preventing rash investment decisions that might result in a 20% tax penalty for early withdrawal. In addition, advisors help make sure clients are protected from unforeseen risks through products like life and long-term care insurance and encourage investors to plan for a financially secure retirement.

**It is a fundamental shortcoming of the DOL benefit calculation that it equates variance in the performance between and within some mutual fund products as being a valid measure of the**

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<sup>41</sup> RIA p. 87.

<sup>42</sup> See, e.g.: [www.kitces.com/blog/betterment-digital-raises-fees-adds-plus-premium-and-advisor-network](http://www.kitces.com/blog/betterment-digital-raises-fees-adds-plus-premium-and-advisor-network) "Betterment Raises Fees and Pivots to Platform Offering Human Advisors." And [www.financial-planning.com/news/personal-capital-reverses-course-raises-account-minimums-to-100k-again](http://www.financial-planning.com/news/personal-capital-reverses-course-raises-account-minimums-to-100k-again) "Personal Capital Reverses Course, Raises Account Minimums to \$100K Again."

**value of retirement planning services. In fact, much of the benefit of retirement planning services results from the advisor's ability to encourage diversification into products such as non-traded investment vehicles or various insurance products precisely because the performance of these products is not strongly correlated to the performance of financial markets. Investors also benefit from advisor's behavioral coaching and other soft services.**

Valuing the soft benefits of financial advising is notoriously difficult, but some have attempted to do so.<sup>43</sup> One study published by Vanguard, for example, estimates that access to an advisor can add 300 basis points to an investor's expected return.<sup>44</sup> In this as in other studies, much of the benefit results from behavioral coaching; the ability of an advisor to encourage savings, establish and maintain long-term strategies; and eliminate the emotional decision-making that often accompanies periods of market volatility. Although 300 basis points is a significant improvement in investment performance, studies of this nature by their very design tend to underestimate the value of retirement planning services. Listed below are examples of categories of advice that are not adequately captured in studies limited to a comparison of expense and return ratios:

- Retirement planning: Older investors often have investment concerns that transcend an analysis grounded in expense and return ratios. For example, investors in or near retirement often confront difficult financial tradeoffs such as the desire to preserve assets for estate planning against the need to generate current income. Access to a financial advisor can result in improved financial planning that helps to achieve these objectives. However, the optimal strategy selected in these circumstances will likely transcend a simple comparison of expense and return ratios.
- Suitability of low- or no-return products: Financial advisors bring value by encouraging investors to purchase products that are suitable for long-term life cycle planning but will actually reduce short-term investment return. Encouraging the purchase of insurance for long-term nursing home care is an important example. In addition, conservative bond funds that generate income but low return are entirely appropriate investments for large segments of the retirement investor population rather than focusing on aggressive funds with higher rates or return.

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<sup>43</sup> In addition to the Vanguard study discussed below, see also Blanchett, David and Paul Kaplan (2013) "Alpha, Beta, and Now... Gamma." <https://corporate1.morningstar.com/uploadedFiles/US/AlphaBetaandNowGamma.pdf>, which estimates a 160-basis point value of advising services. Others who have explored the issue include Marsden, Mitchell et. al. (2011) "The Value of Seeking Financial Advice." *Journal of Family and Economic Issues* 32(4): 625-643.

<sup>44</sup> Putting a value on your value: Quantifying Vanguard Advisor's Alpha. Kinniry, Jaconetti, DiJosespeh, Ziberling, and Bennyhoff; Vanguard Research; September, 2016.

- Availability of non-traded products: Often non-traded products serve an important role in providing income streams from assets that will not fluctuate in synchronization with equity or bond markets. Non-traded REITS are an example of such a product that is available to non-accredited investors through a financial advisor. (Note: because by definition these are non-traded assets, access to the retail customer would not be possible without the intermediation of a financial advisor).

The value of advising becomes a significant factor in the overestimation of benefits from the Fiduciary Rule because the rule is leading to the loss of advising services for many small investors, as discussed below.

### **3.5 A SPECIAL NOTE ON SMALL INVESTORS**

One of the important results of the fiduciary rule is that large numbers of small investors will lose access to retirement planning services. More than 50% of all retirement accounts have \$50,000 or less in assets; and nearly 70% have assets of less than \$100,000.<sup>45</sup> The combination of lower fees and high fixed transaction costs means that it is no longer economical for many advisors to serve smaller clients. Whereas all firms interviewed reiterated their commitment to meeting the needs of smaller investors, many suggested that below certain asset levels as a practical matter smaller investors will be directed to web-based products that do not rely on a financial advisor. The range of asset size at which this transition is expected to occur varied from \$25,000 to \$70,000 in assets per firm interviewed. Moreover, financial advisors are small business with their own overhead expenses to cover; consequently, their breakeven point may be lower still. One financial advisor whom we interviewed reported that although he remains committed to serving small investors, the current economics may not allow for these relationships to continue. As a result, small investors will be doubly disadvantaged. They will lose access to the retirement planning services that will help them increase their retirement assets, and this will then further limit their ability to take advantage of products and services that can enhance financial security during retirement years.<sup>46</sup>

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<sup>45</sup> Copeland, Craig. Employee Benefit Research Institute. Issue Brief, January 17, 2017. Number 429. "Individual Retirement Account Balances, Contributions, Withdrawals, and Asset Allocation Longitudinal Results 2010-2014: The EBRI IRA Database.

<sup>46</sup> This point is hotly contested in section 8.4.4 of the RIA: "the Department believes that quality, affordable advisory services will be amply available to small plans and investors under the final rule and exemptions" (p. 312). While the DOL offers a variety of arguments for this position, the direct experience of our interview subjects leaves little doubt that the reality of the Fiduciary Rule is one of small investors losing access to the traditional advising experience, although firms and financial advisors would prefer to avoid terminating existing client relationships.

## 4. MARKET-BASED SOLUTIONS CAN BETTER SERVE INVESTORS

A consistent message conveyed by the subject-matter experts whom we interviewed was that there are emerging market-based solutions that are evolving that will effectively achieve many of the same objectives that the DOL has sought through regulation. At the same time, several examples were pointed out where the DOL rule would reverse practices and services that had their genesis in market pressure to address consumer demand.<sup>47</sup> While there can be no doubt that some of these developments have been accelerated by the promulgation of the rule, it is important to note that the industry was already well on its way to addressing many of the objectives sought by proponents of the rule even before the rule was published.<sup>48</sup>

### 4.1 EMERGING MARKET SOLUTIONS

The financial industry has responded to the fiduciary rule by experimenting with various pricing and product innovations that provide investors with more transparent and level pricing. The challenge for the industry is that there is little opportunity for the industry coordination that would accelerate adoption of generally accepted industry standards. In part, this lack of coordination is attributable to anti-trust concerns. Importantly, uniform standards require acceptance from the broker-dealer community, product manufacturers, and service-platform providers. Most importantly, time is required for market solutions to develop, get implemented, and prove acceptable to consumers. The tight time frame imposed by the fiduciary rule severely restricts the ability of the industry to properly develop these emerging market solutions, particularly since the most promising solutions require some degree of industry standardization. To a large extent, solutions must be implemented sequentially as firms adapt the infrastructure, training and oversight necessary to accommodate new product modifications. Despite these obstacles, there is already much evidence that the industry is moving toward price standardization as illustrated by the following examples.

The tight time frame imposed by the rule, severely restricts the ability of the industry to properly develop and implement market solutions.

- Transaction (T-) Shares: T Shares have been explored as an industry approach to standardize pricing on mutual fund purchases. In general, T-Shares offer standardized upfront commission and consistent treatment of so-called 12B-1 fees (which cover distribution, marketing, and service costs). Industry experts whom we interviewed explained that this initial

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<sup>47</sup> The insights expressed throughout this chapter reflect consensus views expressed during our interviews with experts and executives from within the community of independent financial services firms.

<sup>48</sup> For example, the U.S. Securities and Exchange Commission (SEC) approved amendments proposed by FINRA to promote greater transparency for investors in certain non-traded investments (known as FINRA 15-02). This rule also addressed the handling of customer account statements for non-traded real estate investment trusts (REITs) and non-traded business development companies (BDCs).

attempt at addressing requirements imposed by the fiduciary proved complex, and many expressed objection to some T-Share characteristics. One important objection expressed is that the lower up-front cost will lose its appeal when investors are charged higher fees during routine rebalancing of accounts; or for other investors who lose the benefit of reduced fees that result as a right of accumulation. Most of those interviewed agreed the limitations of T-Shares are a result of the time pressure (created by the rule) to bring a new share class to market.

- **Clean Shares:** To address some of the shortcomings identified during the development and testing of T-Shares, Clean Shares (also known as Wholesale Shares) have begun to emerge as a new share class in mutual funds. Clean Shares provide a uniform up-front price but allow advisors to layer servicing and other costs on top of these standardized prices. One of the key challenges to Clean Shares is that broker-dealers will need to devise and implement new commission structures to replace revenue lost from product manufacturers (12(B)-1 fees). This approach appears to have great promise for investors, and industry experts interviewed for this study supported fee standardization and transparency; but also noted that at the present time many broker-dealers lack the administrative or technological infrastructure to begin introducing a new fee structure, and until this infrastructure is properly developed there will be strenuous objection to losing (without replacement) revenue that is needed to cover service and maintenance expenses. Moreover, at the present time these shares are not widely available; and as previously noted, would require time for the sequential implementation by different firms that major new products require if they are to be available to all investors. However, there was much confidence expressed that with sufficient time, these hurdles could be overcome.
- **Annuities:** Most broker-dealers interviewed report movement toward modified pricing structures in annuity products. The most common pricing structures generally involve level up-front commissions that are much lower than previously offered but coupled with the introduction of trailing fees. Pricing within each annuity product class is standardized to reflect such characteristics as investment, tax, and income objectives, as well as the age of the investor purchasing the annuity. Given the complexity of the underlying investment mix coupled within each annuity, and the fact that broker-dealers are dependent upon product manufacturers to provide the detailed cost information required to convert to new commission schedules, converting to a new standardized commission schedule is proving to be challenge for many firms. Adding to the challenge is the problem that many times the new level-fee structure results in higher lifetime commission costs for the investor relative to the larger one-time up-front commission charge previously common to these products.
- **REIT fees:** Non-traded REITs are highly valued by investors but difficult for financial advisors to sell, given the complexity of complying with the

requirements of the fiduciary rule. In response, several leading broker-dealers have (independently) worked with REIT issuers to modify pricing structures that will allow these companies to feel comfortable about continuing to offer these products on their platforms. In response to this dynamic, REIT pricing is evolving toward a standard that combines a lower up-front load cost with new residual trailing fees. As more broker-dealers and issuers explore this new pricing structure, it is expected that market solutions acceptable to investors, broker-dealers, and issuers will result in more uniform pricing standards.

#### **4.2 HOW REGULATION CAN UNDO MARKET SOLUTIONS**

One consequence of the fiduciary rule is its potential to reverse or eliminate many services or practices that have proven beneficial to investors. The following three examples, illustrate this trend.

- **Commission pricing:** One well-established consequence of the fiduciary rule is a general discouragement of commission-based pricing in favor of fee-based payment structures. This trend has the potential to move many investors into payment structures that prove costlier to the investor or that are contrary to the investor's payment philosophy. Investors with large assets who trade infrequently will almost always do better under commission-based rather than fee-based pricing. Similarly, many investors simply prefer to pay fees specific to each transaction, rather than general fees covering a wider range of services. The reduction in access to commission pricing will result in harm to these investors.
- **Non-billable assets:** Many clients hold assets in their fee based account which are not billed upon. For example, the financial advisor may choose not to charge on cash balances, or perhaps provides no advice on a subset of assets, or on an asset originally purchased in a commission account. Under the rule, many of these clients will find their overall costs increased as advisors lose the flexibility to adjust fees to the particular asset mix of the investor. More flexibility than what is allowed by the current rule is needed to allow for billing structures better suited to each client's unique circumstances.
- **Non-traded REITs:** Non-traded REITS are attractive to investors seeking income streams from real estate assets whose value does not fluctuate with the stock market. Over the last 10 years, these products have reportedly become more accessible to smaller retail (non-accredited) investors. The illiquid nature of the product coupled with an investment that is specific to an underlying asset means that there is more risk associated with the investment. The fiduciary rule essentially requires a best-interest contract (BIC) before an advisor can sell products with these specialized characteristics, so the economics of offering the product to retail investors

no longer works. The increased risk of litigation coupled with downward pressure on fees will move these products back upstream and out of reach of smaller investors.

#### **4.3 PROMOTING COLLABORATION**

As described in our earlier chapter on the cost estimate associated with the fiduciary rule, higher costs for the independent financial services firms will cause serious disruption to the industry. Many of the objectives of this costly rule might reasonably be expected to be better achieved through market-based solutions. However, to fully explore market based solutions there must be more time allowed, and an environment which does not raise anti-trust concerns.

There is already movement toward much needed collaboration among regulatory agencies. For example, the SEC has recently sought public comment on exploring the relationship between applicable SEC regulation and DOL's fiduciary rule<sup>49</sup>. A coordinated effort between regulatory agencies with overlapping responsibility can best ensure that investors are protected by a best interest standard whether they are investing in a retirement or non-retirement account. In another example, the National Association of Insurance Commissioners reports that it has established an Annuity Suitability Working Group to examine the fiduciary rule and its impact on insurance products.

Moreover, collaboration is required among market participants because solutions will usually require the simultaneous development of complex and expensive infrastructure. For example, mutual fund companies create the products, clearing platforms create the trading systems to accommodate them, broker-dealers must create the commission and compliance systems to handle the new shares. Moreover, some of those interviewed reported that fee-based annuities modified to comply with the rule, while available, are currently have limited accessibility in the marketplace. Although an important source of income for retirees, there is currently no easy way for investors to access these products because the fee-based annuity technology has yet to be installed on fee-based retirement platforms. Annuity manufacturers need additional time to install these products on distribution platforms before they can be offered to investors.

More time and more industry collaboration will likely produce better outcomes for investors. For example, one major broker-dealer reported during our interviews that a full conversion to T-shares, will result in harm to just over 50% of their clients in commission mutual fund purchases. This firm found in its internal examination that just over 50% of purchases were made at a breakpoint that resulted in lower loads than the 2.50% load on T shares. In addition, financial advisors require education about the new share pricing structures, compliance requirements, and trading processes.

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<sup>49</sup> Public Statement of Chairman Jay Clayton of the United States Security and Exchange Commission issued June 1, 2017. "Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker-Dealers"

## 5. CONCLUSION

The fiduciary rule has imposed enormous cost and disruption to independent financial services companies and the investors whom they serve. Oxford Economics estimates that the direct costs incurred by broker-dealers in complying with the rule's requirements will be nearly 300% that estimated by the DOL.

At the same time, our analysis demonstrates that the DOL has significantly overestimated the benefit that might reasonably be attributed to the rule. This overestimation occurs because the DOL has too narrowly based its benefit calculation on differences in front-loaded (domestic only) mutual fund performance while ignoring the rules contribution to limiting product choice, access to financial advisors, and commission accounts. Simply including foreign as well as domestic mutual fund performance reduces the DOL's benefit calculations to one tenth it's reported amount. At the same time, the DOL has ignored altogether the value of financial advice.

The DOL underestimated the rule's cost and the time required for an orderly transition; and overestimated the rule's purported benefit.

The promulgation of the rule has accelerated trends in the industry that are now irreversible. The challenge for both the industry and its regulators is to create an environment that will allow these emerging trends to evolve into market-tested solutions that address many of the objectives desired by the rule's proponents while also meeting the needs of the investors whom the rule was intended to protect. The current rule provides neither the time frame nor structure to allow for this positive outcome. FSI members that we interviewed expressed a desire for:

- More time to allow market solutions to develop.
- Greater coordination among all of the relevant regulators.
- Increased opportunity for industry involvement in adopting and implementing appropriate industry standards.

One suggestion that emerged during our interviews was the desirability of an appropriate (regulatorily sanctioned) task force that fostered the coordination necessary to establish innovative new industry standards that would allow implementation of cost-effective strategies for better meeting the needs of retirement investors. This task force might include representatives from the broker-dealer community, product manufacturers, and service platform providers and could recommend better alternatives than regulation to achieving the most important of the DOL's objectives without the necessity of cumbersome regulation. There are already in the market, emerging solutions to addressing DOL objectives such as:

- Level commission structures. There are already trends under way with mutual funds, annuity and REIT products to couple reduced up-front commissions with the introduction of smaller trailing commissions. The most cost-effective strategies for implementing this pricing will involve coordination among product issuers, broker-dealers, and service platform providers.

- Third-party payments. The broker-dealer business model is generally reported to be a low-margin business. In its prior studies, FSI has reported that the net profit of its member financial services firms averaged 1.6%. Consequently, trends toward eliminating third-party payments become a significant challenge when the lost revenue is not replaced. There is reportedly some movement or discussion toward supplementing level commission structures with explicit commission surcharges imposed by broker-dealers to offset servicing costs. At present, however, many firms lack the administrative and technological infrastructure to properly explore this option.
- Disclosure requirements. There are significant costs associated with the various disclosure requirements mandated by the fiduciary rule. There are the direct costs of mailing; the opportunity cost of devoting precious time with clients to discussing paperwork; and the practical costs of trying to accumulate and disseminate the information required.

**Rushing to impose new standards that have not been fully tested in the market in order to comply with artificially imposed regulatory deadlines, is not a sound strategy for protecting the best interest of retirement savers.**

# APPENDIX A - METHODS

## COST SURVEY

In order to generate cost estimates for this report,<sup>50</sup> Oxford Economics, in consultation with FSI, prepared and distributed a survey asking FSI member firms to estimate costs of the final rule, broken out across 16 categories of expense type. In each category, estimates were sought for start-up costs incurred to date, expected future start-up costs if the rule goes into effect, and expected annual recurring costs. All FSI firms were invited to participate; 14 ultimately did so. One of these 14 was not able to provide detailed cost breakouts, only total start-up and recurring costs. Because these totals were close to the average of other small firms, in order to maintain consistency between the total estimates and the category estimates, we excluded the results from this firm, leaving 13 firms in our survey (five small, five medium, and three large).

This survey is similar in form to the survey we conducted in our 2015 report, which asked FSI member firms to estimate expected start-up costs to comply with the final rule, broken out across seven categories of expense type. In the earlier work, as in this work, we presented both estimates of total firm start-up costs, as well as mean and median start-up costs for each of the seven categories. Because interpretations of cost categories differ, in that work, where firms provided no estimate for a particular cost category, we counted this as a zero in the total cost estimates, but as a missing observation in the category estimates. DOL apparently either did not understand this process, or understood and took issue with it, and described the results as a “data discrepancy” between our total cost estimates and our category estimates.<sup>51</sup>

In the current work, given the greater number of cost categories and thus the larger number of excluded categories in individual firm response, and to avoid similar misunderstandings, we treat missing category-level cost estimates as zeros in both the totals estimates and the category estimates. Nevertheless, it should be understood that firms may interpret cost categories somewhat differently, and the estimates by detailed category may be affected by this.

All results presented are simple averages across surveyed firms by size category. Total costs for FSI members are calculated by multiplying these averages by the number of FSI firms.

## INTERVIEWS

In preparing this report, Oxford Economics conducted ten interviews of FSI member firms of varying sizes and specialties, and related industry players. This is

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<sup>50</sup> These cost estimates were previously presented in our April 2017 report.

<sup>51</sup> <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf> section 5.3.

in addition to ten interviews we conducted for our April 2017 report, and the interviews for our original 2015 paper.

Discussions were wide ranging, including both prepared questions and an open-ended invitation to provide any additional information. The interviews were documented but not recorded; however, anonymity was a precondition of those interviewed.

# APPENDIX B – DETAILED COST TABLES

Below are detailed tables corresponding to the cost category graphs in section 2. Note that totals do not add precisely due to rounding.

**Fig. 9: Start-up costs by detailed category**

Category	Small BDs	Medium BDs	Large BDs
Planning & management	\$394,000	\$896,000	\$1,557,000
Payment to clearing house	\$0	\$1,024,000	\$409,000
Best interest contracts	\$55,000	\$203,000	\$3,631,000
Compliance oversight	\$32,000	\$256,000	\$1,459,000
System interfaces/feeds	\$23,000	\$333,000	\$857,000
Disclosure modifications	\$73,000	\$255,000	\$752,000
Client communications	\$29,000	\$151,000	\$888,000
Other	\$58,000	\$130,000	\$699,000
Additional vendor costs	\$58,000	\$69,000	\$787,000
Training / educational	\$80,000	\$77,000	\$429,000
Website	\$21,000	\$98,000	\$238,000
Records retention	\$7,000	\$109,000	\$217,000
Commission systems changes	\$38,000	\$97,000	\$155,000
Transaction reporting	\$0	\$60,000	\$398,000
Vendor interface	\$0	\$29,000	\$345,000
Reporting quarterly returns	\$39,000	\$0	\$167,000
E&O insurance	\$4,000	\$0	\$118,000
<b>Total</b>	<b>\$911,000</b>	<b>\$3,787,000</b>	<b>\$13,105,000</b>

Source: Oxford Economics

**Fig. 10: Recurring costs by detailed category**

Category	Small BDs	Medium BDs	Large BDs
Payment to clearing house	\$5,000	\$1,020,000	\$2,000
Disclosure modifications	\$28,000	\$100,000	\$2,842,000
Best interest contracts	\$61,000	\$186,000	\$1,665,000
Compliance oversight	\$50,000	\$234,000	\$0
Additional vendor costs	\$25,000	\$160,000	\$445,000
Client communications	\$14,000	\$96,000	\$576,000
E&O insurance	\$5,000	\$0	\$984,000
Planning & management	\$13,000	\$113,000	\$4,000
Transaction reporting	\$0	\$70,000	\$171,000
System interfaces/feeds	\$17,000	\$52,000	\$100,000
Training / educational	\$20,000	\$44,000	\$69,000
Website	\$10,000	\$51,000	\$30,000
Records retention	\$5,000	\$43,000	\$66,000
Reporting quarterly returns	\$42,000	\$0	\$83,000
Commission systems changes	\$9,000	\$40,000	\$0
Vendor interface	\$10,000	\$7,000	\$12,000
Other	\$30,000	\$192,000	\$326,000
<b>Total</b>	<b>\$344,000</b>	<b>\$2,407,000</b>	<b>\$7,375,000</b>

Source: Oxford Economics

# APPENDIX C – OVERVIEW OF INDEPENDENT FINANCIAL SERVICES FIRMS

Independent financial services firms operate a distinct business model that aims to help investors by providing comprehensive and affordable financial services. IBD-affiliated financial advisors are self-employed business owners and often serve a distinct geographic region where they have strong community ties and a local reputation. An impact study we completed in 2016 found that FSI-affiliated financial advisors operate store-front businesses on the main streets of virtually every small to mid-sized city in the United States.

This proximity to clients allows FSI members to provide access to competent and affordable financial planning services and investment products to all investors regardless of their wealth level. FSI members and their affiliated financial advisors primarily engage in the sale of packaged products, such as mutual funds, variable insurance, and annuity products. Investment advisory services are provided through either affiliated registered investment adviser firms or affiliated firms owned by their financial advisors.

The provision of these services to investors across the US, in turn, generates a significant amount of economic activity. With nearly 160,000 jobs directly employed within the sector, FSI member firms support nearly \$48.3 billion in economic activity across the US, as well as an additional 322,400 jobs. This economic activity generates more than \$6.8 billion in federal, state, and local taxes. In short, IBDs generate value to investors as well as contribute significant value to the US economy. Disruptions to the IBD model jeopardize this value creation. Appendix D provides summary data on the economic contribution of the industry.

# APPENDIX D – ECONOMIC IMPACT OF FSI MEMBERS

## AN INTRODUCTION TO ECONOMIC IMPACT ANALYSIS

A standard economic impact assessment identifies three channels of impact that stem from an activity:

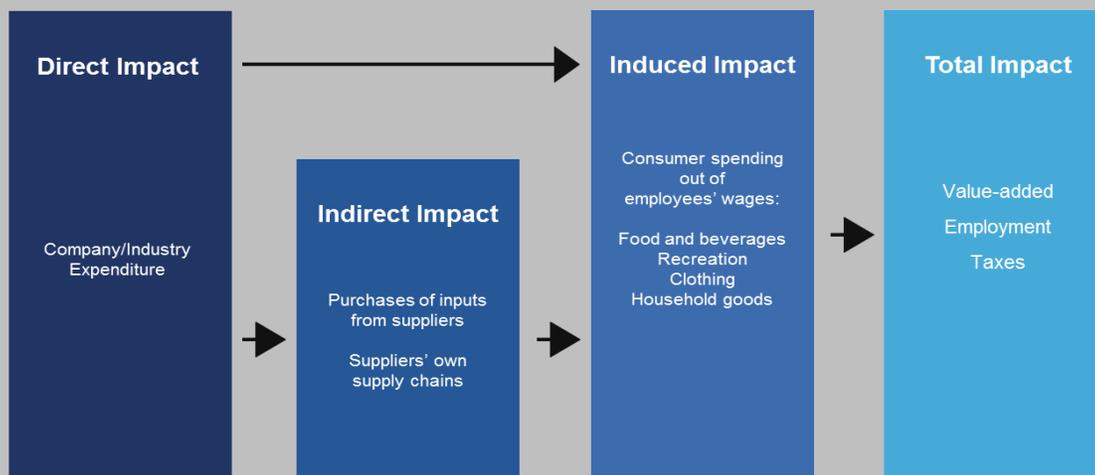
- **Direct effect.** These measures the economic benefit of FSI members' operations and activities in the US.
- **Indirect effect.** Encapsulates the activity driven by the supply chain as a result of FSI members' procurement of goods and services from other businesses.
- **Induced effect.** Captures the impact of workers spending their wages on locally produced goods and services. This supports activity across the spectrum of consumer goods and services, and their supply chains. An example of this is the purchases a worker makes using his wages, including groceries, clothing, transportation, and utilities.

In accordance with standard economic impact assessments, the scale of the impact of FSI member firms is measured using three key metrics:

- **GVA** — The gross value-added (GVA) contribution to GDP
- **Employment** — Generally measured in terms of headcount of workers
- **Taxes** — Representing gross tax receipts paid at federal, state, and local levels

All monetary impacts are for 2015 and are presented in 2015 dollars.

Fig. 11: The channels of economic impact



## ECONOMIC IMPACT OF FSI MEMBERS

Taking the direct, indirect (supply chain), and induced (wage spending) impacts together, the total impact of FSI members on the US economy amounted to \$48.3 billion in 2015, equivalent to about 0.27% of the total US economy (US GDP was \$17.9 trillion in 2015).

The total GVA impact (direct + indirect + induced) of FSI members is displayed in Fig. 12:. It is broken down into the major sectors of the US economy. FSI members' direct impact is entirely in the financial activities sector. Not surprisingly this is the sector where FSI members have the greatest overall national impact (\$28.8 billion). In fact, 59.6% of FSI members' overall GVA impact is felt in the financial activities sector.

Still, 40.4% of FSI members' GVA impact is generated in a diverse set of sectors outside of financial activities. Other than financial activities, the three sectors where FSI members have the greatest impact are professional and business services (10.0%); trade, transportation and utilities (8.7%); and education and health services (5.8%).

**Fig. 12: FSI members' GVA impact by sector**

Sector	Direct	Indirect	Induced	Total
\$ millions				
Natural Resources and Mining	0	79	643	721
Construction	0	97	187	284
Manufacturing	0	333	1,623	1,955
Trade, Transportation, and Utilities	0	685	3,518	4,203
Information	0	954	931	1,885
Financial Activities	18,637	4,742	5,429	28,808
Professional and Business Services	0	2,833	2,014	4,847
Education and Health Services	0	2	2,787	2,788
Leisure and Hospitality	0	279	1,255	1,534
Other Services	0	213	874	1,087
Government	0	43	141	184
Total	18,637	10,260	19,400	48,297

Source: Oxford Economics, IMPLAN

The total employment impact (direct + indirect + induced) of FSI members is displayed in Fig. 13:. Similar to the GVA impacts, the employment impacts are concentrated in the financial activities sector, accounting for 46.7% of the total employment impact. This is followed by professional and business services (13.3%); trade, transportation and utilities (10.4%); and education and health services (9.7 %).

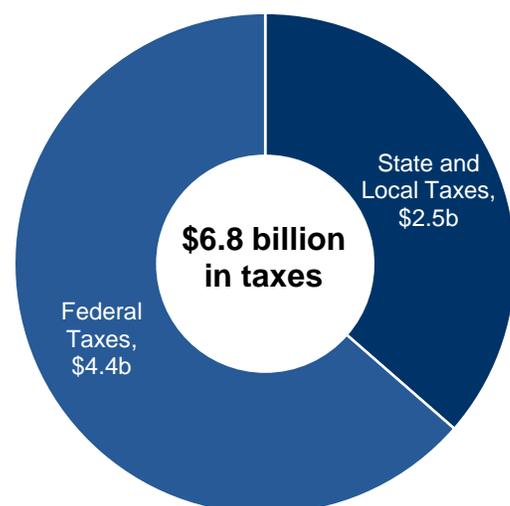
**Fig. 13: Detail FSI members' jobs impact by sector**

Sector	Direct	Indirect	Induced	Total
jobs (000s)				
Natural Resources and Mining	0.0	0.4	5.2	5.6
Construction	0.0	1.3	2.6	3.9
Manufacturing	0.0	3.0	10.5	13.6
Trade, Transportation, and Utilities	0.0	7.5	42.7	50.3
Information	0.0	4.4	3.9	8.4
Financial Activities	159.7	39.4	26.3	225.4
Professional and Business Services	0.0	36.8	27.1	64.0
Education and Health Services	0.0	0.0	46.9	46.9
Leisure and Hospitality	0.0	7.8	32.6	40.4
Other Services	0.0	2.4	18.3	20.7
Government	0.0	1.0	2.0	3.0
<b>Total</b>	<b>159.7</b>	<b>104.2</b>	<b>218.2</b>	<b>482.1</b>

Source: Oxford Economics, IMPLAN

The direct, indirect, and induced economic activity supported by FSI member firms generated \$4.4 billion in federal tax revenue in 2015 and an additional \$2.5 billion in state and local tax revenue. In total, the economic activity that FSI member firms generated was worth over \$6.8 billion in taxes for all levels of government (Fig. 14:). In total, each job created by FSI activity results in \$42,570 in additional tax revenue (from all sources).

**Fig. 14: FSI members' tax impact**



Source: Oxford Economics, IMPLAN

## GEOGRAPHY OF IMPACTS

FSI members operate in every state in the US. Fig. 15: and Fig. 16: below provide two maps that show how FSI members' economic impact differs between large states and smaller states. Fig. 15: illustrates how FSI members make a disproportionately larger impact in smaller and mid-sized states. Nevertheless, as Fig. 16: illustrates, FSI members make their largest (absolute) economic impact in states hosting the largest financial sectors (e.g., New York, California, Texas). Taken together, these maps demonstrate that FSI members are an important component of the financial services industry in all 50 states but are a disproportionately important member of the financial services community in small and mid-sized states. Stated differently, FSI members make a disproportionately large economic contribution to communities that are traditionally underserved by other segments of the financial services industry.

**Fig. 15: FSI member firms in small and mid-sized states**

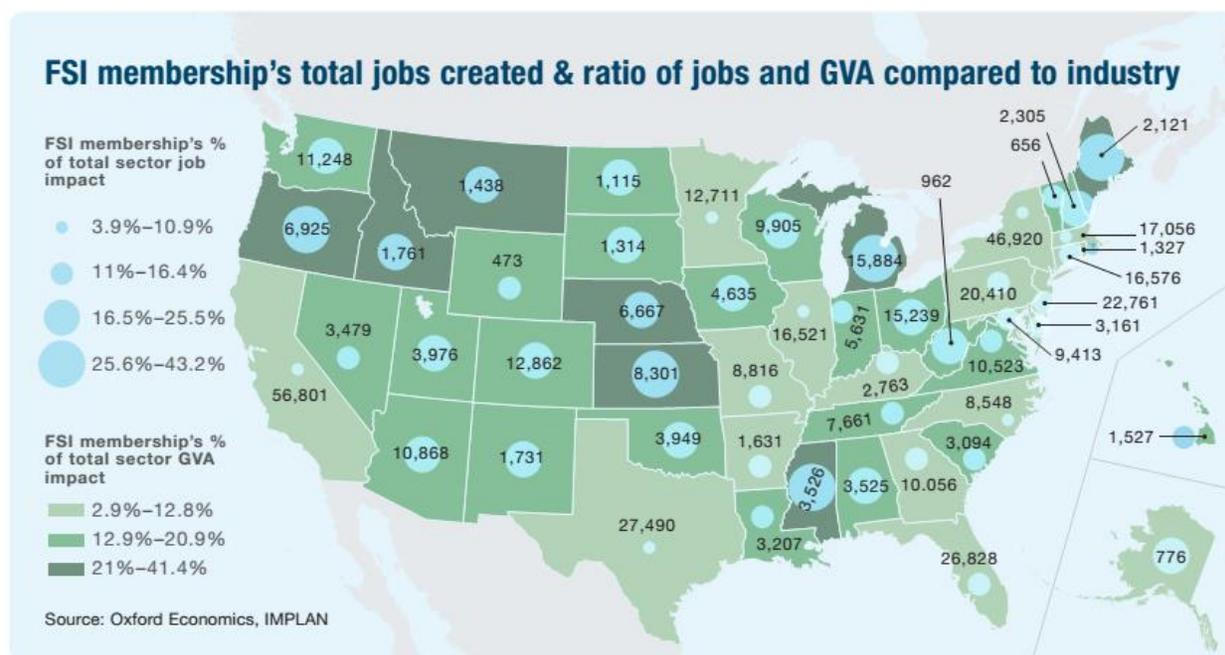


Fig. 15: highlights FSI members' disproportionate contribution to smaller and mid-sized states by measuring FSI contribution in that state relative to the financial services industry's overall contribution to that state. This relative comparison is done both for jobs attributed to FSI (the bubble in each state) and FSI members' contribution to state GDP (the background color of each state).

FSI members' GVA contribution relative to the overall industry's GVA contribution is greatest in states such as Mississippi (41.1%), Maine (36.4%), and Kansas (30.1%). When FSI members' employment contribution is compared to overall industry employment contribution then other smaller states also emerge near the top of the pack including Oregon (29.4%), Michigan (28.0%), and Montana (25.5%).

**Fig. 16: FSI member firms in large states**

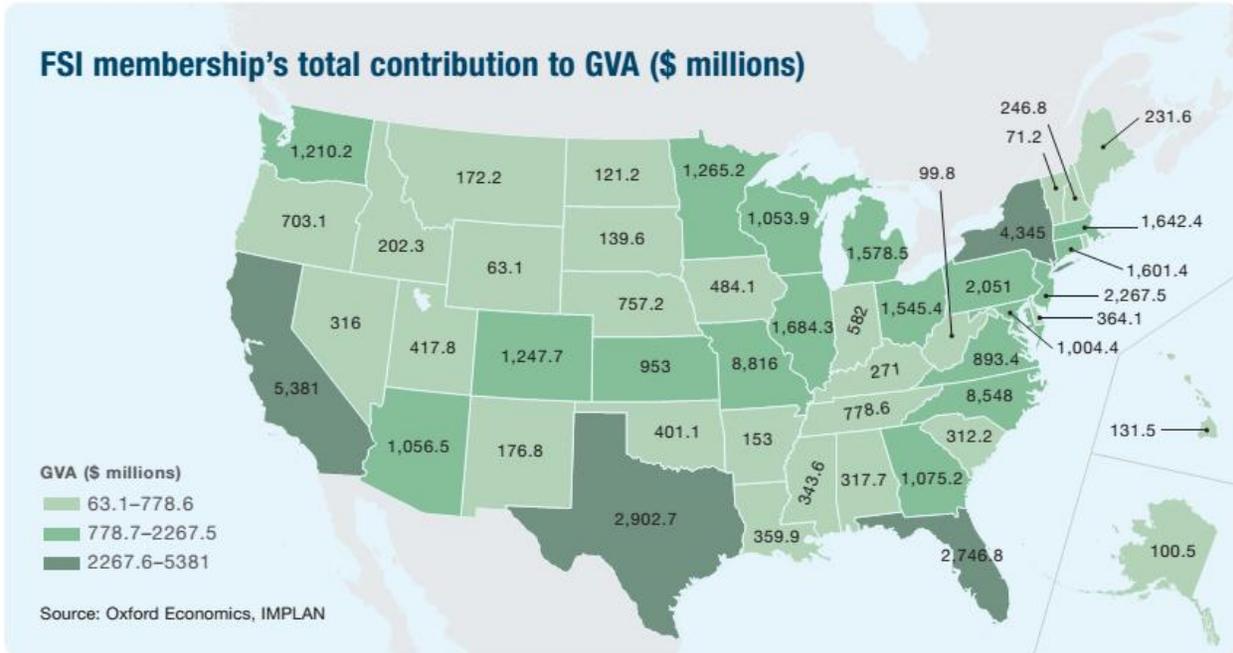


Fig. 16: demonstrates that in absolute dollar terms, FSI members' economic impact is greatest in those states with the largest financial sectors. The five states where FSI members had the greatest impact account for 35.5% of FSI member economic impact nationwide, and these include California (\$5.3 billion), New York (\$4.3 billion), and Texas (\$2.9 billion). Even in states with very large financial services sectors, FSI members make an important economic contribution.



**Europe, Middle East,  
and Africa:**

**Global headquarters**

Oxford Economics Ltd  
Abbey House  
121 St Aldates  
Oxford, OX1 1HB  
UK  
Tel: +44 (0)1865 268900

**London**

Broadwall House  
21 Broadwall  
London, SE1 9PL  
UK  
Tel: +44 (0)20 7803 1418

**Belfast**

Lagan House Sackville Street  
Lisburn  
County Antrim, BT27 4AB  
UK  
Tel: + 44 (0)2892 635400

**Paarl**

12 Cecilia Street  
Paarl 7646  
South Africa  
Tel: +27(0)21 863-6200

**Frankfurt**

Mainzer Landstraße 41  
60329 Frankfurt am Main  
Germany  
Tel: +49 69 95 925 280

**Paris**

3 Square Desaix  
75015 Paris  
France  
Tel: +33 (0)1 78 91 50 52

**Milan**

Via Cadorna 3  
20080 Albairate (MI)  
Italy  
Tel: +39 02 9406 1054

**Dubai**

Jumeirah Lake Towers  
Dubai,  
UAE  
Tel: +971 56 396 7998

**Americas:**

**New York**

5 Hanover Square, 19th Floor  
New York, NY 10004  
USA  
Tel: +1 (646) 786 1879

**Philadelphia**

303 West Lancaster Avenue  
Suite 2e  
Wayne, PA 19087  
USA  
Tel: +1 (610) 995 9600

**Mexico City**

Emerson 150, Despacho 802  
Col. Polanco, Miguel Hidalgo  
México D.F., C.P. 11560  
Tel: +52 (55) 52503252

**Boston**

51 Sawyer Road  
Building 2 - Suite 220  
Waltham, MA 02453  
USA  
Tel: +1 (617) 206 6112

**Chicago**

980 N. Michigan Avenue,  
Suite 1412 Chicago  
Illinois, IL 60611  
USA  
Tel: +1 (773) 372-5762

**Los Angeles**

2500 Broadway, Building F,  
Suite F-125  
Santa Monica, 90404  
Tel: +1 (424) 238-4331

**Florida**

8201 Peters Road,  
Suite 1000  
Plantation,  
Miami 33324  
USA  
Tel: +1 (954) 916 5373

**Toronto**

2425 Matheson Blvd East  
8th Floor Mississauga, Ontario  
L4W 5K4  
Canada  
Tel: +1 (905) 361 6573

**Asia Pacific:**

**Singapore**

6 Battery Road  
#38-05  
Singapore 049909  
Tel: +65 6850 0110

**Hong Kong**

30/F, Suite 3112  
Entertainment Building  
30 Queen's Road Central  
Tel: +852 3103 1096

**Tokyo**

4F Tekko Building  
1-8-2 Marunouchi  
Tokyo  
100-0005  
Tel: +81 3 6870 7175

**Sydney**

Level 56, MLC Centre  
19-21 Martin Place  
Sydney, NSW  
Tel: +61 2 9220 1707

**Email:**

mailbox@oxfordeconomics.com

**Website:**

www.oxfordeconomics.com