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Office of Regulations and Interpretations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, DC 20210

Re: Conflicts of Interest Proposed Rule

Definition of the Term “Fiduciary”; Conflict of Interest Rule – Retirement Investment
Advice (RIN 1210-AB32)

Proposed Best Interest Contract Exemption (ZRIN: 1210-ZA25)

Proposed Amendments to Various Exemptions (ZRIN: 1210-ZA25)

Ladies and Gentlemen:

PFS Investments Inc. (“PFSI”), a registered broker-dealer and an indirect wholly-owned subsidiary of Primerica, Inc. (“Primerica”), is pleased to submit this comment on the proposed Conflicts of Interest Rule (“Proposed Rule” or “Proposal”) that would more broadly define the term “fiduciary” under Internal Revenue Code (“IRC”) section 4975. We appreciate the opportunity to share our thoughts regarding this critical rule-making. We focus our comments on the Proposed Rule’s impact on the middle-income savers and investors who we have diligently and successfully served for over 30 years.

PFSI respectfully submits that the Proposed Rule will cause significant harm to middle-income individuals and families by restricting their ability to save for retirement through Individual Retirement Accounts (“IRAs”). In the Proposed Rule, the U.S. Department of Labor (the “Department”) has greatly expanded the definition of fiduciary such that nearly every conversation a financial professional has with a potential retirement saver will be construed as fiduciary advice. Accordingly, transactions effected in connection with a financial professional’s assistance will be subject to reversal and penalties under the prohibited transaction rules unless it falls within a prohibited transaction exemption. We acknowledge the Department’s statement that it has sought to craft an exemption that allows the continuation of the very popular brokerage-based IRA, designated by the Department as the Best Interest Contract Exemption (“BIC Exemption”). Regrettably, we find the BIC Exemption to be unworkable. In short, the requirements of the BIC Exemption are so complex and burdensome that it is not administratively or operationally feasible. We believe the Proposed Rule will still require broker-dealers to fundamentally restructure their IRA businesses, resulting in higher minimum

account balances beyond the reach of millions of middle-income households, reduced access to financial professionals, reduced investor choices, and ultimately, lost opportunities to accumulate meaningful retirement savings on a tax-deferred basis for millions of hard-working Americans in the middle-income market.

In Section I of this letter, we introduce Primerica as a company. We discuss how we help middle-income families save for retirement and the importance of our face-to-face services in encouraging these savings. In Section II, we address the over-breadth of the proposed fiduciary definition. In this discussion, we request the retention of key elements of the current definition, such as the requirement of “mutual understanding” by the client and the financial professional that the relationship is a fiduciary one. We further request that the definition include a meaningful “seller’s exception” for retail investors, and that the exception for investment education be broadened rather than narrowed. In Section III, we discuss our concern that the BIC Exemption is unworkable as written, and suggest specific changes that could potentially make the BIC Exemption operational. In Section IV, we briefly address the faulty legal basis of the Proposal. Finally, in Section V, we summarize our recommendations with respect to the Proposal.

I. Who We Are and How We Help Middle-Income Families

A. How Primerica Reaches Middle-Income Households

Primerica is a leading distributor of basic savings and investment products to middle-income households throughout the United States. Our typical clients are middle-income consumers, defined by us as households with an annual income of \$30,000 to \$100,000, a category that represents approximately 50% of all U.S. households. As is widely known, the smaller-sized transactions typical of middle-income consumers have induced most financial services companies to focus on more affluent consumers and abandon the middle-income market. Primerica’s business model, however, is designed to allow us to provide exceptional service to the middle-income market, and to do so in a sustainable manner. All PFSI representatives are independent contractors, hold the necessary Financial Industry Regulatory Authority (“FINRA”) and state registrations, and are compensated by commissions resulting from product sales. Our business model allows our representatives to concentrate on the smaller-sized transactions typical of middle-income consumers and provides clients access to personal services that would usually not be available to middle-income investors with smaller account balances.¹

Primerica has limited its offering of investment products to those that are most appropriate for our middle-income clients. Through PFSI, our affiliated broker-dealer, we offer open-end mutual funds and variable annuities, all from well-known and respected companies, as well as many different savings vehicles, including taxable accounts, IRAs, and college savings plans. Our platform includes off-the-shelf products, with commissions on par with those paid to other product distributors.

¹ We will open an IRA account for an individual with as little as \$250 to invest, or for \$50 per month.

Likewise, our investment education and philosophy is geared toward our middle-income clients, who oftentimes are new or less experienced investors. In that regard, we produce easy to understand educational pieces teaching fundamental investing concepts. In our educational outreach efforts, we often partner with our product providers.² Our primary investing principle, which is consistent throughout our educational pieces, is the long-term benefit of dollar-cost averaging through systematic investing into a diversified investment portfolio. To help our clients adopt this approach, our affiliated shareholder servicing entity, Primerica Shareholder Services (“PSS”), facilitates periodic investments (monthly or quarterly) into mutual fund accounts by processing electronic bank drafts against client checking accounts for five platform fund families.³ In addition to the advantages of dollar-cost averaging and diversification, PFSI emphasizes the benefits of asset allocation, which spreads investment dollars across different asset classes in an effort to reduce risk and increase returns. By any measure, PSS has been highly successful in aiding Americans to save; it currently handles transactions for over 1.2 million client accounts, and was recently awarded the 2014 DALBAR Service Award⁴ for exemplary client service for the twelfth consecutive year.⁵

At Primerica, our representatives reflect and serve the communities in which they live. Accordingly, they are well-acquainted with the financial challenges facing the middle-income market. The diversity of our sales force reflects the make-up of the middle-income market and continues to be a primary strength of our company. There is no doubt that our representatives are a big reason for our success, as well as the success of many middle-income American families in starting to save for their retirement and future.

B. Our Focus on Saving for Retirement

Our investing products and principles fit hand-in-glove with the primary financial need of most middle-income Americans, which is the need to establish a long-term savings plan for retirement. In response to this need, Primerica and its representatives have made providing retirement savings education and information a priority. Over our history, we have produced and distributed hundreds of thousands of educational brochures that discuss saving for retirement.⁶

² See, e.g., Legg Mason’s *Discover the 3D’s of Investing*, available at www.leggmason.com (click on US Investors/Products & Insight; then Literature; then ClearBridge Appreciation Fund).

³ The five fund families available on the PSS platform are American Century, Franklin Templeton, Invesco Funds, Legg Mason and Pioneer Investments.

⁴ DALBAR, Inc. is the financial community’s leading independent expert for evaluating, auditing and rating business practices, customer performance, product quality and service.

⁵ See www.dalbar.com/AwardsRankings/AwardHistory. As a service provider to the five mutual fund companies on our platform, PSS receives recordkeeping and shareholder servicing fees from those companies (or their affiliates). This is a common arrangement in the mutual fund industry. In essence, these five fund companies are paying PSS to perform services for shareholders that they, or their affiliates, would otherwise have to perform.

⁶ For example, some of the current retirement brochures are identified as follows: Investing at Retirement; Asset Management; IRAs; Power of Dollar-Cost Averaging; Invest for Success; and ABC’s – The Basics of Investing.

We introduce clients to fundamental retirement savings concepts, such as the difference between expected retirement age and life expectancy, the “Rule of 72” which produces the years required to double one’s investment based on an assumed rate of return, and how inflation and rate of return affect a long-term savings plan. As a result of our efforts to educate American families about the need to save for retirement, and to provide beneficial, cost-effective retirement solutions, in just about any given year more than half of all accounts opened by PFSI are IRAs.

C. *The Real Issue for Middle-Income Americans Is the Lack of Retirement Savings, Not Conflicts*

Our experience in serving middle-income Americans has shown us that the real issue for this group of investors is not that their retirement accounts are negatively affected by conflicts, but rather that far too many of them have simply failed to take the steps necessary to accumulate meaningful retirement savings. This lack of retirement savings is borne out by the research.

The Survey of Consumer Finances (the “SCF”) is conducted by the Federal Reserve Board every three years and is a leading source of data on American’s wealth. It provides detailed information on the incidence of retirement plan ownership by American families, and categorizes the results by different criteria, one of which is family income. In its analysis of the results of the 2013 SCF, the Employee Benefit Research Institute (the “EBRI”) finds that participation in an employment-based retirement plan (either a defined benefit or defined contribution plan) is strongly linked to family income.⁷ According to the EBRI’s report, in 2013 the SCF shows that 67.1% of all families with an income of \$100,000 or more had someone participating in a plan at a current job. But in middle-income America, with incomes below \$100,000, participation is significantly lower; in 2013, just 53.5% of families with incomes ranging from \$50,000 to \$99,999 had a participant in a plan. In the \$25,000 to \$49,999 income range, participation is even lower; in 2013, the number of families with a participant in a plan at a current job was just 25.8%.⁸ What these results show is that for whatever reason, the middle-income market is currently participating far less in employer-sponsored retirement plans than the more affluent market.⁹

Also, the SCF takes a more inclusive look at retirement plan ownership by measuring the percentage of all families with a participant in an employer-based plan or an IRA or Keogh plan. A wide variance in participation remains. In 2013, for families with incomes of \$100,000 or more, fully 93.0% had a participant in one of these plans. But for families with incomes of \$50,000 to \$99,999, participation drops to 81.8%, and for incomes of \$25,000 to \$49,999,

⁷ See Craig Copeland, *Individual Account Retirement Plans: An Analysis of the 2013 Survey of Consumer Finances*, EBRI Issue Brief, no. 406, November 2014, available at www.ebri.org.

⁸ *Id.* at 7 (Figure 2).

⁹ This negative trend is an ominous sign for retirement savings in the middle-income market, Oliver Wyman recently found that 84% of more than 4,300 retail investors surveyed only began saving for retirement via a workplace retirement plan. See Oliver Wyman, *The Role of Financial Advisors in the US Retirement Market, Key Findings* (July 6, 2015), at 5.

participation drops to a lowly 58.9%.¹⁰ Lack of participation is particularly acute in the lower income range, where more than 4 out of 10 families have no retirement account or savings.

Finally, the EBRI report allows further insight by reviewing the SCF data on *total average retirement portfolio account balance* for families in any plan or IRA. The SCF categorizes all families into five net worth percentiles. Again, the average retirement account balances drop off considerably in the lower three net worth percentiles. These balances are \$69,144 for the 50-74.9% percentile, \$18,543 for 25-49.9%, and only \$10,458 for families with a net worth in the bottom 25%.¹¹ This data confirms that retirement savings is *heavily* skewed to higher net worth families, and that everybody else needs to save more. Those families with a net worth in the bottom 50%, which would be most middle-income families, are in real trouble.

The EBRI report confirms that, for middle-income Americans, the lack of retirement savings is a serious problem. The real issues that the Department and the Administration should be focused on are Americans' lack of retirement savings and poor financial literacy. In fact, because the Proposal will make retirement information and advice harder to obtain for middle-income Americans, it will, unfortunately, make a bad situation worse. For us, the Proposal will make it more difficult for our representatives – who are on the frontlines and living in these most affected communities – to continue to effectively educate middle-income families on the benefit of retirement savings.

D. Middle-Income Families Need Help to Understand the Need to Save for Retirement

In the New York Times bestselling book “Nudge,”¹² behavioral economist Richard Thaler and law professor Cass Sunstein draw from behavioral science research to propose ways that sensible “choice architecture” (the context in which people make decisions) can successfully “nudge”¹³ people toward better decisions, without giving up their freedom of choice. One of the societal problems they examine is saving for retirement, and the choices that participants make, or fail to make, inside of employer based retirement plans. In so doing, the authors provide their insights into why saving for retirement is such a challenge for many people:

The standard economic theory of saving for retirement is both elegant and simple. People are assumed to calculate how much they are going to earn over the rest of their lifetime, figure out how much they will need when they retire, and then save up just enough to enjoy a comfortable retirement without sacrificing too much while they are still working.

¹⁰ See Copeland, *supra* note 7, at 10 (Figure 5)

¹¹ *Id.* at 11 (Figure 6).

¹² Thaler, Richard H. and Sunstein, Cass R., “Nudge: Improving Decisions About Health, Wealth, and Happiness” (Penguin Books; Revised & Expanded edition, 2009) (All cites are to the paperback edition).

¹³ The authors define a nudge as “any aspect of the choice architecture that alters people’s behavior in a predictable way without forbidding any options or significantly changing their economic incentives.” *Id.* at 6.

As a guideline for how to think sensibly about saving, this theory is excellent, but as an approach to how people actually behave, the theory runs into two serious problems. First, it assumes that people are capable of solving a complicated mathematical problem in order to figure out how much to save. Without good computer software, even a trained economist would find this problem daunting. The truth is that we know few economists (and no lawyers) who have made a serious attempt at doing it (even with software).

The second problem with the theory is that it assumes that people have enough willpower to implement the relevant plan. Under the standard theory, flashy sports cars or nice vacations never distract people from their project of saving for a condo in Florida. In short, the standard theory is about Econs [previously described as the “textbook picture of human beings offered by economists”, that “think like Albert Einstein, store as much memory as IBM’s Big Blue, and exercise the willpower of Mahatma Gandhi”¹⁴], not Humans [real people that “have trouble with long division if they don’t have a calculator, sometimes forget their spouse’s birthday, and have a hangover on New Year’s Day”¹⁵].¹⁶

We agree with the authors’ opinion that the decision to save for retirement is one where most people need help to do the right thing. They explain that the act of saving for retirement tests one’s self-control, and that “self-control issues often arise when choices and their consequences are separated in time.”¹⁷ This seems particularly relevant, as when a 37-year-old parent opts to put off saving for retirement, a decision that will not have consequences for 20 or 30 years, in order to buy a new car, a choice that generates immediate gratification. Finally, the authors posit that it is particularly hard for people to make good decisions when they have trouble translating the choices they face into terms that they can easily understand.¹⁸

Thaler and Sunstein conclude that saving for retirement is, for most people, a hard choice, and that people need a “nudge,” or help, to do the right thing. We completely agree, especially for people in the middle-income market, where the decision to allocate a portion of limited resources to savings often means passing on some other purchase or activity. We believe that it is our representatives, empowered with our educational materials and ability to successfully service small balance accounts, who are this “nudge” or help for many American families. This Proposal may severely limit our ability to continue to provide this valuable personal service or function.

¹⁴ *Id.* at 6.

¹⁵ *Id.* at 6.

¹⁶ *Id.* at 106.

¹⁷ *Id.* at 75.

¹⁸ *Id.* at 74.

E. People that Use Financial Professionals Report Better Results in Retirement Savings

In May of this year, the LIMRA Secure Retirement Institute published the results of its 2014 Consumer Survey.¹⁹ The results show that “advisors” (defined as paid financial professionals, such as brokers, financial planners, or advisors) add significant value to the clients they serve by encouraging them “to save holistically”, including for retirement. For nearly every identified savings goal surveyed (except vacation), LIMRA found that “advisors’ clients are significantly more likely to save on a regular basis compared with people who don’t consult advisors.”²⁰ Specifically with respect to retirement, LIMRA found that people who work with advisors (as broadly defined) are more than twice as likely (54% with advisors, as opposed to 26% without) to save for retirement on a regular basis (outside of the workplace) than people who do not work with advisors.²¹ With respect to pre-retirees (ages 55 to 70), LIMRA found that those that use advisors are more likely to have performed key planning activities than pre-retirees who do not use advisors; these activities include: calculation of the amount of assets they will have available for retirement (58% with advisors, as opposed to 30% without), determination of their income in retirement (56% as opposed to 39%), determination of their retirement expenses (52% as opposed to 32%), estimation of how many years their assets will last in retirement (50% as opposed to 23%), and identification of the activities they plan to engage in and their likely costs (42% as opposed to 24%). Finally, in an earlier survey, LIMRA found that pre-retirees that use advisors consider themselves significantly better prepared for retirement than those who do not consult an advisor.²²

Another recent study conducted by consulting firm Oliver Wyman, attached as Appendix 1, confirms that financial representatives add substantial value to their client’s financial, and retirement, well-being.²³ The study focused on the role of financial representatives in the U.S. retirement system, and primarily drew upon proprietary surveys of more than 4,300 retail investors (the “Retail Investor Retirement Survey”) and analysis of two datasets from IXI Services, a division of Equifax.²⁴ Based on the Retail Investor Retirement Survey, the study found that on average, individuals that use a financial representative have more assets than

¹⁹ See Matters of Fact: Consumers, Advisors and Retirement Decisions (and Results); LIMRA Secure Retirement Institute (May 2015), available at <http://www.limra.com/>.

²⁰ *Id.* at 6. The identified savings goals were as follows: retirement (outside of the workplace), education, specific one-time large purchase (other than home), home purchase, vacation or travel, unexpected expenses/rainy day fund, home improvement, medical costs, and taxes.

²¹ *Id.* at 6.

²² See *Advisor Perspectives on Retirement Planning*, LIMRA Secure Retirement Institute (2012).

²³ Oliver Wyman states that it “was engaged to perform a rigorous investigation of the role of financial advisors in the US retirement market, and quantify differences in investing behavior and outcomes between advised and non-advised individuals.” Oliver Wyman, *The Role of Financial Advisors in the US Retirement Market*, at iii.

²⁴ See *id.* at iii-iv (About This Report).

non-advised individuals across all the age and income levels examined. For example, concerning individuals with \$100,000 or less in annual income (*i.e.*, middle-income individuals), Oliver Wyman found that advised individuals have a minimum of 38% more assets than non-advised individuals.²⁵ Moreover, with respect to individuals in or approaching retirement, the differences in assets are even more significant. On average, advised individuals ages 55 to 64 had 51% more assets than non-advised individuals, and those 65 and older had 113% more assets (*i.e.*, more than double) than the non-advised.²⁶ These are meaningful differences in assets for middle-income individuals that use advisors, which should translate into significant improvements in their retirement living.²⁷

Oliver Wyman’s analysis of the IXI dataset, representing approximately 20% of U.S. consumer-invested assets, substantiated its findings from the retirement survey. With respect to middle-income savers (\$100,000 or less in annual income), Oliver Wyman found that on average, individuals who employ the services of an investment professional, like a broker, have had “at least 50% more” in total invested assets than others since at least 2006, the first year of the dataset.²⁸ This advantage in total invested assets rose throughout the 2009 recession and its immediate aftermath, and remained at “more than 200% more” in total invested assets from 2011 through 2013, the last year of the dataset. When looking only at IRA assets, Oliver Wyman found similar results. From 2006 to 2008, IRAs of advised individuals had, on average, approximately “40% more assets” than the IRAs of the non-advised.²⁹ During the 2009 recession and its immediate aftermath, this advantage rose sharply to “more than 50% more” in IRA assets for the advised for 2010 through 2013. Also, Oliver Wyman analyzed total IRA assets by age group in 2013, and found that for individuals with \$100,000 or less in annual income, those with advisors had higher IRA assets in all age brackets, ranging from a low of 39% more IRA assets in the 18-to-34 age bracket, to a high of 87% more IRA assets in the 55-to-64 age bracket.³⁰ Clearly, the sharp rise in the advantage of advised individuals in both total invested assets and IRA assets during the 2009 recession and its immediate aftermath is a testament to the benefit of receiving the assistance of a financial representative during a period of extreme market turmoil.

Finally, Oliver Wyman also found that advised individuals more often displayed investing practices “commonly associated with long term investing success,” which included having more diversified portfolios, staying invested in the market by holding significantly less cash, taking fewer premature cash distributions, and rebalancing their investments to a desired

²⁵ *Id.* at 16.

²⁶ *Id.* at 16.

²⁷ The study states that their findings hold true, even when excluding survey respondents who anticipate receiving retirement income from either an inheritance or trust fund.

²⁸ Oliver Wyman, *The Role of Financial Advisors in the US Retirement Market*, at 17.

²⁹ *Id.* at 17.

³⁰ *Id.* at 24.

asset allocation more frequently.³¹ Again, we believe that the Proposal will harm middle-income savers by unnecessarily disrupting the relationship between the client and her chosen financial professional.

II. The Proposed Rule Will Significantly Disrupt Retirement Savings for Middle-Income Americans

Based on our vast experience with working with middle-income American families and the research cited above, we are deeply concerned that the Proposed Rule will have the unintended effect of depriving middle-income consumers of desperately-needed retirement guidance from SEC- and FINRA- regulated financial professionals. We anticipate the result will be an industry-wide movement to further abandon the middle-market and focus on affluent clients. The “haves” will be afforded personal services, while the “have-nots” will be left without personal assistance to fend for themselves online, or will be steered away from tax-advantaged IRAs entirely.

We do not say this lightly. Since the Proposed Rule was first released, PFSI has spent significant effort parsing the rule and determining how the Proposal would impel us to modify our operations. Given the Department’s stated intent to preserve business models and provide flexible “principles-based” guidance, we were initially hopeful. However, we regrettably conclude that the BIC Exemption – the way that the Department seeks to preserve the commission-based brokerage model for retirement accounts – requires such significant people, process and technology changes, not to mention increased exposure to litigation risks, that in the end, it does not appear to be operationally practical or feasible to implement. The Proposal will harm the very consumers it was intended to protect.

If the Department’s Proposal is finalized as proposed, “Main Street” consumers – young families saving what they can each month – will be separated from their chosen financial professional and lose access to the commission-based brokerage model that has served them so well. They are likely to be limited to investing in taxable accounts, or be left with no in-person financial professional to encourage (or “nudge”) them to save at all. For those with more to invest, the choice likely will be limited to more costly advisory services.³²

For these reasons, we urge the Department to withdraw the Proposed Rule. We believe the Proposal is unnecessary and that the Department has failed to clearly establish how the Proposal addresses the real retirement savings issues confronting America: lack of financial literacy and will to save for retirement. If the Department nevertheless continues with this Proposal, we urge the Department to take its time to reconsider how the Proposal will affect the average saver. Substantial revisions are necessary to preserve choice and access to financial and

³¹ *Id.* at 2.

³² Garber, Steven, Burke, Jeremy, Hung, Angela, and Talley, Eric, *Potential Economic Effects on Individual Retirement Account Markets and Investors of DOL’s Proposed Rule Concerning the Definition of a “Fiduciary,”* Rand Corporation, Rand Labor and Population, RR-1009-DOL, February 2015, prepared for the Department of Labor, at 18 (“The number of professional advisers needed to serve the IRA market would be expected to decrease as a result of adopting the rule to the extent that broker-dealers exit the IRA market or take steps to reduce their IRA-related advisory activities.”).

investment services for middle-income Americans. To get these revisions right will require more time than the Department has proposed to provide for a final rule to become effective and applicable. Specifically, the Department should revise the proposed definition of fiduciary investment advice to: (1) retain key elements of the current five-factor fiduciary definition, including the mutual understanding element which is critical to allowing clients and their representatives to define their financial services relationship; (2) provide for a meaningful “seller’s exception” for retail investors; and (3) preserve investment education by broadening, not narrowing, the education exception.

A. The Proposed Definition of Fiduciary Is Too Broad

The Proposed Rule greatly expands the scope of who is a fiduciary and when fiduciary status begins and ends. To do so, it eliminates the current “five-part test,” and instead introduces vague and novel terminology that could have the result of imposing fiduciary status on almost every conversation that a representative may have with a potential client. For example, the Proposal removes the fundamental requirement that advice be provided pursuant to a “mutual understanding”. The proposed removal of mutuality as a necessary condition to establish a fiduciary relationship is alarming. Without that element, under the Proposed Rule fiduciary status could ensue even when there is no agreement, indication, or intention by either party at the time that the representative will act as a fiduciary. There is risk that an “understanding” that is not “mutual” can be unilaterally asserted after the fact, leaving no way for a representative to prove the contrary.

The Proposal also eliminates the requirement that the advice be “individualized”. The Proposal instead requires only that the advice be “directed to” a client “for [the client’s] consideration”. Yet, “directed to” could encompass nearly any communication received by an investor, including forms of targeted and public advertising. The Department has offered no guidance in this regard. Further, “for consideration” could include information that is not relied upon in making an investment decision. The proposed definition also lacks specificity regarding when the fiduciary relationship begins and ends. As a result, the Proposal will likely have a chilling effect on valuable, non-fiduciary communications with clients.

It is well understood that fiduciary status brings with it significant duties and responsibilities as well as significant liability and risk, including harsh penalties for prohibited transactions. Moreover, though not currently subject to a fiduciary standard of care under the IRC, fiduciaries to IRAs are subject to high standards of care under securities and banking laws and regulations, as well as state laws. Breaches of these standards can result in regulatory penalties and state law claims. Firms and their representatives who become fiduciaries under the Proposed Rule and who seek to rely upon the proposed BIC Exemption would face even broader liability than the Department seems to appreciate. They would be required to adhere to the BIC Exemption’s contractual best interest standard of care, and the Department seeks to give investors a non-waivable right to bring class action claims in court based on breaches of this standard, as well as strict liability under the prohibited transaction rules. Of course, any firm that assumes fiduciary liability and risk will face increased compliance and other costs with respect to its fiduciary services. These costs will ultimately be reflected in how firms structure their business models to mitigate risks, and is likely to affect the types of clients the firm serves, and

the firm's compensation and fee arrangements. It is also likely that these costs will be passed on to consumers.

Because of these high duties and significant risks, we believe that fiduciary duties should not be imposed unless the representative and the investor specifically agree to a fiduciary relationship, and that a representative and an investor should also be able to agree to limit the scope of that relationship.

RECOMMENDATION: The proposed definition of fiduciary investment advice should be narrowed to make it clear that fiduciary status is based upon a mutual understanding or agreement, and that advice is individualized and intended for the recipient's material consideration.

B. The Seller's Exception Should Be Available to Retail Investors

We agree with the Department's statements that the current financial marketplace is complex, and that retirement investors, particularly middle-income investors, need help navigating the many choices they must make to achieve better retirement outcomes. But we submit that the Proposal will have an effect that is the opposite of the Department's stated intentions. The Department should not upend the right of middle-income Americans to choose the representative they desire to work with and the level of service they want. Absent a fiduciary definition that clearly allows clients and their representatives to choose whether or not to enter into a fiduciary relationship, the Proposed Rule should allow for a "seller's exception" that extends to all Americans. A person should not be considered to be an investment advice fiduciary when the client understands, or reasonably should understand, that the person is acting as a sales representative and not as a fiduciary. In short, as under current law, retail investors should be trusted to understand the difference between sales activity and fiduciary investment advice.

The distinction between *sales pitches* and fiduciary investment advice is long-standing, and has been recognized by both the Department and the courts.³³ For example, in *Farm King*

³³ See *Farm King Supply, Inc. v. Edward D. Jones & Co.*, 884 F.2d 288 (7th Cir. 1989); see also *Leimkuehler v. Am. United Life Ins. Co.*, 713 F.3d 905, 911-12 (7th Cir. 2013) (confirming that, standing alone, selecting both funds and their share classes for a menu of investment options offered to 401(k) plan customers does not transform a provider of annuities into a functional fiduciary under ERISA); *Hecker v. Deere & Co.*, 556 F.3d 575 (7th Cir. 2009) (citing *Farm King* and finding that "merely playing a role or furnishing professional advice" in the selection of funds is not enough to transform a company into a fiduciary), *reh'g denied*, 569 F.3d 708 (7th Cir. 2009), *cert. denied*, No. 09-447 (Jan. 19, 2010); *Am. Fed'n of Unions, Local 102 v. Equitable Life Assurance Soc'y*, 841 F.2d 658 (5th Cir. 1988) (noting that simply urging the purchase of products does not make an insurance company an ERISA fiduciary with respect to those products); *Golden Star, Inc. v. Mass Mut. Life Ins. Co.*, 3:11-cv-30235-PBS (D. Mass. May 20, 2014) (while service provider had reserved the right to delete or substitute the mutual funds offered to the plan without either providing any notice of changes or opportunity to reject them, or allowing the plan to engage a different service provider in the event of a rejection, it had never exercised that authority or acted in any way other than in a ministerial fashion with respect to the plan menu, so it was not a fiduciary on this basis); *Santomenno v. John Hancock Life Ins. Co. (U.S.A.)*, 56 Employee Ben. Cas. 1131 (D.N.J. 2013) (holding that a plan service provider was not an ERISA fiduciary with respect to its fees because it "negotiated its service provider fees at arm's length" and because the fees were fully disclosed; nor was the service provider a fiduciary with respect to its selection of a particular fund that paid revenue sharing as an investment option because the service provider did not have the ultimate authority over which investments were included in the plan); *Zang v. Paychex, Inc.*, 728 F.

Supply, Inc. v. Edward Jones, the Seventh Circuit considered a client’s “agreement” with a broker-dealer to listen to the broker-dealer’s “sales pitch” and, if the client liked the pitch, to purchase from among the suggested investments. The court observed that the broker-dealer offered the plan individualized solicitations “much the same way a car dealer solicits particularized interest in its inventory,” and concluded that there was no basis to conclude that the broker-dealer’s activities would have resulted in fiduciary status. This distinction makes sense, and should continue to apply under the Proposed Rule. Though the Department appears to have recognized the distinction in its proposed carve-out for sales to certain institutional investors, it seems that the Proposed Rule would not allow sales and marketing communications – even communications that a new or inexperienced investor would construe as sales pitches rather than impartial advice – to continue to be provided to middle-income investors on a non-fiduciary basis. We strongly urge the Department to fully recognize the broad application of the long-standing, common-sense distinction between sales activity and fiduciary investment advice by inserting a broadly applicable “seller’s exception” into the Proposal.

The exception should require that the seller provide, at the point of sale, a clear, plain English written disclosure which explains: (i) the services to be provided and the compensation to be received in exchange for those services; (ii) that the representative is selling or marketing products or services, and is not acting in a fiduciary capacity, or offering impartial advice; and (iii) any material conflicts the seller and its financial institution may have, including the receipt of higher compensation for selling certain products or services. The primary benefit of a seller’s exception is that it preserves freedom of choice for retirement investors. Instead of being forced into a situation where the options are only higher-cost fiduciary advice or do-it-yourself options, middle-income investors would be able to receive non-fiduciary information if they felt it useful for learning about available products and services. In spite of the Department’s focus on a few unscrupulous financial representatives, the truth is that millions of middle-income Americans like their current representatives, have benefited from their relationships with them, and want to keep these existing non-fiduciary brokerage relationships.

In addition, inserting a “seller’s exception” that removes sales activity from the definition of fiduciary would preserve the services provided by the traditional brokerage model that has evolved under the federal securities laws. As such, it would more closely align the rule with Congressional intent to preserve the traditional brokerage model, as expressed in Section 913 of the Wall Street Reform and Consumer Protection Act (Pub. L. 111-203, H.R. 4173 (the “Dodd Frank Act”)), where Congress considered, but rejected, repealing the broker-dealer exemption in

Supp. 2d 261, 270 (W.D.N.Y. 2010) (citing *Hecker* and holding that a plan service provider that offered a menu of investment options to a 401(k) plan was not a fiduciary, where the parties’ contract required the service provider to give the plan notice of, and an opportunity to reject, any changes to the menu); *Columbia Air Services Inc. v. Fidelity Mgt. Trust Co.*, 2008 U.S. Dist. LEXIS 76999 (D. Mass. Sept. 30, 2008) (citing *Hecker* and following its analysis); *Dupree v. The Prudential Ins. Co. of Am.*, WL 2263892 (S.D. Fla. 2007) (finding “it is well settled” that an insurer is not a plan fiduciary when it sells insurance products and services to a plan, even when it otherwise performs fiduciary functions for the same plan, and that insurers are free to contract with their plan customers on an arm’s-length basis that does not implicate ERISA’s fiduciary standards); *Fechter v. Connecticut Gen. Life Ins. Co.*, 800 F. Supp. 182 (E.D. Pa. 1992) (noting that courts refuse to impose fiduciary obligations on insurance companies who merely sell their products or services to pension plans, unless the insurer assumes decision-making control over the administration or disposition of plan assets, and that simply urging the purchase of its products does not make a company an ERISA fiduciary for those products).

the Investment Advisers Act of 1940 (“Advisers Act”), as a way to impose a higher standard of care on broker-dealers. As the Honorable Barney Frank explained in his letter to the Chairman of the SEC, Congress intended that any new standard “recognize and appropriately adapt to the differences between broker-dealers and registered investment advisers.”³⁴ Because the Proposal could broadly impose fiduciary status on broker-dealers and effectively bar them from receiving commissions with respect to retirement accounts, unless the Department inserts a broad-based “sellers exception”, the Proposed Rule does not appear to conform to Congressional intent.

It is well known that middle-income savers rely heavily on traditional brokerage relationships for help with investments and retirement savings. In its April 2011 study of the impact of the Department’s 2010 proposal on IRA consumers, Oliver Wyman found that 98% of IRA investors with less than \$25,000 were in brokerage relationships, and that 7.2 million retail brokerage IRAs did not have sufficient assets to qualify for an advisory account at any firm in the study.³⁵ It is highly likely that the vast majority of these 7.2 million accounts belonged to middle-income investors. We find nothing in the current Proposal to alleviate the disruption that Oliver Wyman predicted would befall these IRA investors if they are cut off from their existing brokerage relationships. As a result, though unintended, it is predictable that the disruption caused by implementation of the Proposal, which does not provide a workable mechanism by which traditional brokers can continue to provide services to IRAs, will fall primarily on middle-income Americans.³⁶

³⁴ See Letter from the Honorable Barney Frank, Ranking Member of the U.S. House of Representatives Financial Services Committee, to SEC Chairman Mary L. Shapiro, dated May 31, 2011.

³⁵ Oliver Wyman, *Assessment of the Impact of the Department of Labor’s Proposed “Fiduciary” Definition Rule on IRA Consumers* (April 12, 2011), at 2, 16.

³⁶ We note that the SEC took a similar approach that acknowledged the investor’s ability to understand the differences between a brokerage account and an advisory account when it adopted Rule 202(a)(11)-1 under the Advisers Act. That rule, which was later vacated by the D.C. Circuit Court of Appeals on other grounds, allowed broker-dealers to make available fee-based brokerage accounts without subjecting them to the Advisers Act. See *Certain Broker-Dealers Deemed Not to Be Investment Advisers*, Exchange Act Release No. 51523, Investment Advisers Act Release No. 2376 (Apr. 12, 2005), 70 Fed. Reg. 20424 (Apr. 19, 2005); see also *Fin. Planning Ass’n v. SEC*, 482 F.3d 481, 488, 493 (D.C. Cir. 2007) (holding that the SEC exceeded its authority in promulgating the final rule by relying on Section 202(a)(11)(F) of the Advisers Act (now 202(a)(11)(H)) to establish a new, broader exemption for broker-dealers). Among other things, broker-dealers relying on the rule were required to include the following prominent statement in advertisements and account agreements: “Your account is a brokerage account and not an advisory account. Our interests may not always be the same as yours. Please ask us questions to make sure you understand your rights and our obligations to you, including the extent of our obligations to disclose conflicts of interest and to act in your best interest. We are paid both by you and, sometimes, by people who compensate us based on what you buy. Therefore, our profits, and our salespersons’ compensation, may vary by product and over time.” In a subsequent no-action letter, the SEC staff contemplated and provided a process for shifting from an advisory relationship to a brokerage relationship, stating that where a dually registered broker-dealer/investment adviser seeks to terminate an advisory relationship and assume a brokerage relationship, “[d]isclosure by a broker to a customer should be sufficient to enable the client to reasonably understand that the broker-dealer/investment adviser is removing itself from a position of trust and confidence with its client.” See Securities Industry Ass’n, SEC Staff No-Action Letter (pub. avail. Dec. 16, 2005).

RECOMMENDATION: The Department should provide a meaningful seller's carve-out for retail investors that preserves their access to non-fiduciary investment assistance and the commission-based brokerage model.

C. The Education Exception Is Too Narrow

1. Identifying Investment Options

Given the breadth of the proposed fiduciary investment advice definition, the Proposal's investment education carve-out would be one of the few avenues for conveying critical information about investing to middle-income investors without subjecting the provider of such valuable education and assistance to the fiduciary prohibited transaction rules. Though the Department explains that it has based the carve-out on its current guidance under Interpretive Bulletin 96-1, and has made certain clarifications to that guidance, the carve-out's restriction on identifying specific investment options severely hampers its usefulness.

Our representatives help middle-income investors navigate the complex landscape of investment alternatives. They do this by providing education about saving and investing techniques that the client can implement without devoting significant time to complicated research. They educate middle-income families about the general financial and investment concepts cited in the carve-out, and empower them with investment tools that are generally consistent with the carve-out's contemplated requirements. In our experience, this education leads to increased savings and investment decisions that are better-suited to meeting the goals of those investors.

The Department's narrowed carve-out would prevent us from providing our clients with the investment education that would allow them to identify the investment options available that can be used to implement the carve-out's general investment concepts, asset allocation models, and interactive investment materials. We are concerned that the end result will be missed investment opportunities, investment decisions that are not consistent with the education provided, and in the worst case, reduced retirement savings for middle-income Americans, who cannot afford and may not be eligible for full-service investment advisory programs. Thus, we ask the Department to permit financial professionals to continue to identify specific investment options, so long as the information is provided in a non-discriminatory and objective manner, and is accompanied with a robust disclosure about the availability of similar products on other platforms.

RECOMMENDATION: The Department should provide an investment education exception that permits us to identify specific products so that we can provide useable and meaningful education and assistance.

2. Education with Respect to Rollover and Distribution Decisions

The education carve-out also should clarify when and how information can be provided about rollovers and plan distributions, confirming that our representatives will not be deemed to be fiduciaries (under ERISA or Section 4975 of the IRC) solely as a result of providing

information about factors the client should consider in making decisions about rollovers as discussed in FINRA Notice 13-45.

Under the Department's broad construct of "fiduciary," nearly all conversations about rollovers and distributions could be viewed as fiduciary investment advice, including discussions about rollovers from a plan to an IRA and between IRAs, as well as conversations with plan participants about the *availability* of rollover services or regarding help setting up an IRA. As a result, we are concerned that many representatives will be reluctant to discuss options and considerations with investors absent a clearer carve-out for education about rollovers and distributions. Studies show that if employees lose access to retirement assistance at employment termination, they often are likely to cash out some or all of their retirement savings. A 2014 study by Quantria Strategies, LLC estimated that the loss of rollover assistance at job termination could lead to increased cash-outs of \$20-32 billion annually.³⁷

Under the Proposal, fiduciary investment advice would include recommendations with respect to rollovers and plan distributions among the categories of covered recommendations, reversing the Department's prior guidance in Advisory Opinion 2005-23A (the "Deseret Letter") that such recommendations, absent other factors, would not be fiduciary investment advice. We believe the Deseret Letter is correct under the plain terms of ERISA and established principles of the law of trusts. As the Department knows, many firms have relied on the Department's guidance in the Deseret Letter in structuring their services to investors who are eligible for a plan distribution. Investors themselves benefit significantly from these services.

For all of these reasons, the Department should not reverse the position set forth in the Deseret Letter. If the Department does not change the Proposal in this regard, then it must allow us to continue to provide meaningful educational assistance to families who are faced with important and complex decisions about what to do when they are separating from their employer or are otherwise eligible for a distribution. Specifically, the Department should provide clear guidance regarding the types of information that can be provided as investment education that does not implicate fiduciary status. We specifically ask the Department to confirm that financial professionals can provide rollover and distribution education in accordance with FINRA's guidance distinguishing recommendations from investment education, and discuss the factors raised in FINRA Notice 13-45 without being deemed to be a fiduciary, so long as the financial professional clearly notifies the participant that the professional is not acting as a fiduciary, or a representative or agent, of the plan.

RECOMMENDATION: The Department should clarify the investment education exception by specifically incorporating FINRA guidance distinguishing recommendations from investment education in the context of rollovers and distributions.

III. The Exemptions Do Not Address the Actual Issues Facing Middle-Income Families with Respect to Their Retirement Savings

³⁷ Quantria Strategies, LLC, *Access to Call Centers and Broker Dealers and Their Effects on Retirement Savings*, April 9, 2014.

As written, the Proposed Rule is a marked departure from existing law. With such a broad and ambiguous definition of fiduciary investment advice, and without meaningful carve-outs for sales and education activities directed to retail investors, financial institutions are likely to limit the options and assistance available to middle-market retirement savers. Further, without substantive coordination with the legal standards of other agencies, the Proposal risks cutting off opportunities for tax-deferred savings, effectively restricting a substantial portion of the population to saving in taxable accounts. This is particularly true with respect to smaller accounts, where the risk of triggering fiduciary status will outweigh the potential reward. Again, the result will be a two-tiered system of services: those available for the “haves” and self-help options for the “have-nots,” namely young families and lower-wealth individuals who most need guidance and encouragement to save.

A. *The BIC Exemption Is Not Workable as Written*

We draw this conclusion first and foremost because the Department’s expanded definition of “fiduciary” makes prohibited transaction relief necessary to continue to effectively serve IRAs, and because the relief the Department has drafted for commission-based brokerage services to IRAs – the BIC Exemption – is not workable. As a starting point, we agree with the Department that firms and their representatives should always act in their clients’ best interests. In fact, we believe that acting in the clients’ best interests is critical to our business’s long-term success. When our clients can see that they are on the path towards achieving their retirement and other goals, they are more likely to return to us and our representatives, and are more likely to refer their friends and family members to us. The growth and success of our investment business is closely tied to our clients’ growth and success, and our clients’ growth and success depends upon us acting in their best interests.

Though we agree with the best interest standard in principle, the BIC Exemption includes prescriptive conditions that fall short of the Department’s stated intent to adopt a flexible, principles-based approach.³⁸ From start to finish, the BIC Exemption disrupts the personal relationships that we and our representatives have worked hard to develop with our clients, and it fails to offer certainty that the commission model can be preserved, even in a significantly altered, more costly, and less effective form. In operating our business, “certainty” with respect to regulatory compliance matters is critical, because a failure to satisfy the BIC Exemption may result in steep costs to correct prohibited transactions. It may also lead to consumer and class action lawsuits. This is the case even when there has been no client harm or loss. Critically, the technical implementation of the BIC Exemption promises to be a substantial burden, and likely will cause a significant disruption of services to our clients with few added benefits in the way of investor protections.

³⁸ Definition of “Fiduciary”; Conflict of Interest Rule-Retirement Investment Advice; Proposed Rule (Fiduciary Proposal), 80 Fed. Reg. 21,928, *et seq.*, at 21,929 (proposed Apr. 20, 2015) (stating that the Department “sought to preserve beneficial business models for delivery of investment advice . . . that would broadly permit firms to continue common fee and compensation practices, as long as they are willing to adhere to basic standards aimed at ensuring that their advice is in the best interest of their customers.” (emphasis added)).

We are not alone in our observations. The feasibility of the BIC Exemption has been analyzed and will be commented on by others. The difficulty, cost, risk and uncertainty the BIC Exemption imposes likely will cause those firms serving middle-income clients to limit brokerage services and move accounts with higher account balances to advisory services. Millions of existing small-balance IRA owners are likely to lose access to the financial professional of their choice, or any financial professional at all. The majority of others will face higher costs as their accounts shift to advisory accounts, will experience lower savings rates as they increasingly cash out of 401(k)s due to lack of guidance, and will carry excess portfolio risk due to less diversification and less frequent re-balancing.³⁹ According to one study,

Conservative estimates of the combined reduction in retirement assets attributable to the unintended consequences of the re-proposed regulations suggest that the regulations could result in losses of retirement savings of \$68-\$80 billion each year.⁴⁰

The consequence will be negative to “Main Street” retirement savers, particularly to long-term buy-and-hold retirement investors and those with smaller accounts.

Our comments on the BIC Exemption follow below and are focused on identifying the specific conditions that prevent it from providing meaningful relief from prohibited transactions. In each section, we recommend changes to the BIC Exemption that cumulatively may improve its feasibility.

1. Written Contract Will Preclude Reliance on BIC Exemption

a) Timing Is Too Disruptive

The BIC Exemption requires that the financial institution, representative, or retirement investor execute a contract *before* the representative dispenses recommendations. Given the breadth of communications that the Proposed Rule covers as “fiduciary” advice, this requirement makes it imperative that the contract be signed at the very outset of a potential client relationship. Requiring a potential client to execute a formal agreement so early in a putative relationship will likely have a chilling effect on middle-income investors who are already understandably overwhelmed about saving for retirement.

In our experience, prospective clients want to get to know our representatives, probe their financial knowledge, discuss financial goals and generally learn about potential savings plans before deciding to invest. Forcing a prospective client to sign a contract before he or she gets to know our representative and our business will be off-putting and disconcerting. A premature agreement is more likely to make prospective clients anxious about the obligations that they taking on by executing the document, rather than give comfort to them about their rights and

³⁹ Oliver Wyman, *The Role of Financial Advisors in the US Retirement Market*, at 3.

⁴⁰ Quantria Strategies, LLC, *Unintended Consequences: Potential of the DOL Regulations to Reduce Financial Advice and Erode Retirement Readiness* (July 20, 2015), at 29.

protections. Undoubtedly, some prospective clients will choose not to go forward at all. As we have discussed, this would have the effect of curtailing retirement savings. We request instead that the Department require the agreement to be signed at account opening, *after* a prospective client has decided to engage with the firm and the representative. We base the foregoing observations on our and our representatives' decades of experience working with middle-income and new savers, through which we have developed an informed understanding of the types of demands on clients that are likely to cause them to retreat from retaining a firm's services.

The process also inflicts significant added cost, as we undoubtedly will be executing contracts with persons who never become clients. These added costs are likely to result in increased costs for those who do become clients.

RECOMMENDATION: The BIC Exemption contract should not be imposed until account opening.

b) Requiring Representative to Sign Creates Uncertainty

The obligation to have both the financial institution and the representative execute the agreement is also troublesome. If a representative ceases working with us and some of his or her clients would like to continue as clients of another one of our representatives, the client would be required to execute a new agreement with the new representative before proceeding under the BIC Exemption. In the interim period, we would be unable to provide retirement investment services without risking the loss of the BIC Exemption's protection. Likewise, the Proposal does not clarify whether, in situations where multiple representatives participate in client services, the client will need to sign an agreement with each representative. It seems that under the Proposal, if the contracted representative is not available, a recommendation or transaction cannot be made. The inconvenience would be hard to explain, would be frustrating to clients, and could prevent best execution. These ambiguities and similar other difficulties should be addressed and resolved. The Department should expressly permit satisfaction of the BIC Exemption contract requirement via an enforceable agreement between the firm and the investor only, which is distributed to the client without "wet signatures" of the firm, the representative or the client.

RECOMMENDATION: The BIC Exemption contract should not require "wet signatures" or that individual representatives be parties to the contract.

c) Contractual Assumption of Fiduciary Status

Under the proposed regulatory language of the BIC Exemption, the firm and the representative must affirmatively state in a contract that they are fiduciaries with respect to any investment recommendations made to the investor. Yet, it is not clear as drafted whether this requirement is intended to apply with respect to a single recommendation, to the account, or to the investor. Guidance here is needed; without it, we are left uncertain as to whether the requirement mandates an ongoing or long-term advisory relationship. Similarly, it is unclear whether contractual assumption of fiduciary status at point-of-sale effectively imposes an ongoing obligation to provide "best interest" advice, such as account re-balancing, or otherwise to monitor the account. Likewise, it is unclear how or whether the contract can specify the time

at which the fiduciary relationship would terminate. While the Department may have intended flexibility, given the lack of clarity we must consider how the plaintiff's bar and courts will interpret this duty.

RECOMMENDATION: The BIC Exemption should expressly permit a firm and its representatives to contractually agree to be a fiduciary solely with respect to a transaction without an ongoing fiduciary obligation to monitor the account.

2. Transition Rule for Existing Clients Is Too Restrictive

The BIC Exemption provides limited transition relief for existing clients for trail commissions and other compensation in connection with advice that occurred prior to the applicability date of the Proposed Rule. However, the conditions of the BIC Exemption must be satisfied before a firm or its representative makes a buy, hold or sale recommendation to an existing client. The effect is that all current IRA and plan clients would need to execute a contract for the exemption to be available to future transactions. For example, if an existing account holder were to contact their representative on a “bearish” day in the markets inclined to sell and minimize losses, the representative would have to decline to provide assistance until a contract is signed. Historically, financial representatives have played a critical role in this circumstance, serving to calm nervous investors and help them to avoid selling at market lows. Studies show that unsophisticated investors in particular benefit from this professional help.⁴¹

To prevent such “no-service” conversations, firms can be expected to pro-actively send their existing clients a letter just prior to the rule's implementation stating that the Department's rule prevents the firm and its agents from helping the client with his or her IRA unless and until a new contract is in place. Operationally, this would require us to mail or electronically distribute these new agreements to our more than 1.2 million existing IRA clients and then track and document the signed and returned agreements. Most importantly, most clients will not understand why we are asking them to sign a new contract agreement with us so they can continue to receive services that they already have chosen to receive and that we have already been providing. Moreover, we would need to develop systems to record whether the BIC Exemption contract was executed and returned, and systems to retain copies of the executed BIC Exemption contract to be able to prove compliance with the BIC Exemption. All of this will come at a cost in terms of both time and money, which likely would ultimately be passed on to clients. Countless conversations will be deflected and transactions derailed during the process.

While the transition rule allows for compensation received pursuant to an agreement or arrangement entered into prior to the applicability date of the Proposal, the Department should eliminate ambiguity by clarifying that pre-arranged transactions with respect to existing IRA accounts, such as established arrangements for regular deposits to IRA accounts, which are not dependent on new advice, are provided the transitional relief. Further, we request that rather than simply providing “transitional relief,” the Department grandfather existing clients in a meaningful way. Specifically, firms should be permitted to continue providing assistance under

⁴¹ Garber, Burke, Hung, and Talley, *Potential Economic Effects on Individual Retirement Account Markets and Investors of DOL's Proposed Rule Concerning the Definition of a “Fiduciary”*, at 23.

current rules with respect to all retirement accounts opened prior to the implementation date of the final rule.

RECOMMENDATION: Existing accounts and all prospective transactions within them should be grandfathered under the current definition of “fiduciary investment advice” rather than transitioned to the BIC Exemption.

3. *Impartial Conduct Standards and Warranties Create Untenable Uncertainty and Risk with Respect to Common Business Models*

As a condition of the BIC Exemption, firms must contractually agree to provide investment advice that reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would exercise, based upon the investment objectives, risk tolerance, financial circumstances, and needs of the retirement investor, without regard to the financial or other interests of the adviser, financial institution or any of their affiliates or any other party (the “Impartial Conduct Standards”).⁴² In addition, firms must warrant that they have adopted “policies and procedures reasonably designed to mitigate the impact of material conflicts of interest . . . and ensure that individual Advisers adhere to the Impartial Conduct Standards.”⁴³ The Proposed Rule further requires the firm and the representative to agree and warrant that each will not recommend any assets for purchase if the total amount of compensation anticipated to be received by the representative, the financial institution, and their affiliates and any related entities in connection with the purchase, sale or holding of the asset will exceed “reasonable compensation in relation to the total services provided” to the retirement investor.

Among the serious concerns we have, the Impartial Conduct Standards and the “total compensation” condition impose strict liability dependent upon a subjective, facts-and-circumstances analysis. Though a firm might conclude that its practices satisfy the Impartial Conduct Standards, a litigant could claim the contrary after the fact. Thus, firms will not know with any degree of certainty whether its policies and compensation practices effectively satisfy the exemption, absent a final adjudication of the issue by a court or the Internal Revenue Service years later.

There is a significant difference between (i) requiring that the firm to contractually agree to provide its services in conformance with the Impartial Conduct Standards and (ii) requiring actual compliance with the subjective standard, as a condition of the BIC Exemption. With respect to the former, a breach would provide the client a contractual right to sue for damages based on the loss caused by the firm and its representative’s acts or omissions. The latter would expose the firm to strict liability for a prohibited transaction regardless of whether there was even a loss. For this reason, we request that the Department require that the firm contractually agree to provide its services pursuant to the Impartial Conduct Standards, but not require actual adherence to the Impartial Conduct Standards as the condition of the BIC Exemption.

⁴² 80 Fed. Reg. at 21,987.

⁴³ *Id.* at 21,970.

We note that similar risks are managed in the context of ERISA section 404, where remedies are generally balanced against the severity of the infraction; they are not managed under the strict liability prohibited transaction rules. This is because the penalties for engaging in a non-exempt prohibited transaction are severe, and may include undoing the transaction, forfeiture of all compensation, disgorgement of any profits and payment of excise taxes of 15% to 100% of the amount “involved” in the transaction.

Additionally, as discussed in Section V below, the Proposal creates a private right of action that likely goes beyond the authority of the Department.

RECOMMENDATION: The Department should eliminate the warranty requirements from the BIC Exemption, and should not require actual adherence to the Impartial Conduct Standards as a condition of the BIC Exemption.

4. *Lack of Clarity of Terms Means High Risk of Prohibited Transactions*

a) *Best Interests Standard’s “Without Regard” to Firm’s or Representative’s Interests*

As cited above, the Impartial Conduct Standards require firms and their representatives to act “without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party.” In the preamble to the Proposal, the Department makes clear its view that this standard is based on ERISA’s duty of loyalty, which requires fiduciaries to act “solely in the interests” of the plan and its participants, and that the Department expects this standard to be interpreted in light of the judicial experience with ERISA’s fiduciary standards.⁴⁴ This duty has been strictly interpreted to require fiduciaries to act with “complete and undivided loyalty to the beneficiaries of the trust”, and with an “eye single to the interests of the participants and beneficiaries.”⁴⁵ Effectively, the Department has turned the ERISA prudence and loyalty standards into a prohibited transaction applicable to IRAs, and at the same time has made that standard enforceable by IRA owners in state court. We do not believe that Congress intended a breach of the duty of prudence to violate the prohibited transaction provisions of ERISA and the IRC.

Adding to this, the requirement that advice be given “without regard” to the financial interests of the representative may make the standard impossible to satisfy. The “without regard” language may have the effect of limiting the representative to recommending nothing but the lowest fee investment. Should the representative be so restricted, the representative will remain at litigation risk, as the lowest-fee option is not necessarily the choice that is best-suited to the investor. The “without regard to” language also extends to the “other interests” of “any other party”. Neither of these terms is explained and no limits are set. Once again, these

⁴⁴ 29 U.S.C. § 1104(a)(1).

⁴⁵ See *Donovan v. Bierwirth*, 680 F.2d 263, 3 EBC 1417 (2d Cir. 1982); *Freund v. Marshall & Ilsley Bank*, 485 F. Supp. 629, 1 EBC 1898 (W.D. Wis. 1979).

ambiguities are primed to prevent a firm and its representatives from obtaining certainty that they can satisfy the conditions of the BIC Exemption.

RECOMMENDATION: The “best interest” language should adhere to the FINRA formulation – the financial professional should provide recommendations that are in the “best interest of his client and put his client’s interest before his own;⁴⁶ the “without regard” and other extraneous language should be deleted.

b) Reasonable Compensation “In Relation to the Total Services”

The Impartial Conduct Standards require that no recommendation be made if the “total amount of compensation anticipated to be received” by the representative, firm, its affiliates and related entities will “exceed reasonable compensation in relation to the total services they provide” to the investor. No guidance is provided as to how to make the comparison between compensation and “total services,” nor is there guidance to be drawn from other sources. Until now, neither ERISA nor any regulator has required that compensation be justified in relation to the specific services provided to a client or account. Because this new construct is unexplained and untested by the courts, and because failure to satisfy its precepts would mean that transactions would be reversed and that excise taxes could apply, it presents unmanageable risk.

Adding further confusion, a “reasonable compensation” requirement appears twice in different forms in the Proposed Rule. In addition to being included in the Impartial Conduct Standards, Section IV(b)(2) provides that any compensation received in connection with any buy, sale or hold recommendation be “reasonable in relation to the value of the specific services provided to the Retirement Investor in exchange for the payments and not in excess of the services’ fair market value.” The Department provides no guidance as to how to apply the requirement that compensation be no more than “fair market value” for the services. Some of the fees that we collect support our overhead and administrative costs of doing business and are not directly tied to a specific account or transaction. It is not clear whether this mandate would require us to trace every dollar earned with respect to these costs of doing business to a particular account, or to a transaction, in order to document reasonableness or fair market value.

It is also unclear whether the required market comparison means that the BIC Exemption cannot be satisfied by any means other than level fees. This uncertainty increases the risk that a court may interpret the “fair market value” standard to mean that a fee differential could not be justified for different assets classes that are similarly serviced. Similarly, it is unclear whether the language used to describe “reasonable compensation” requires a representative to recommend *only* those funds with the lowest revenue share or other third-party payments, on the grounds that a higher-fee fund would provide unreasonable benefit to the firm or representative. As noted above, this interpretation would make the Proposal impossible to satisfy, as the lowest-cost investment is not always in the client’s best interest.

⁴⁶ See, e.g., FINRA Regulatory Notice 12-25, Q1 at 3 (May 2012) (citing FINRA rules that adhere to this formulation).

By requiring compliance with this standard as a condition of the prohibited transaction exemption, the Department may have undermined its effort to preserve existing business models. To achieve its stated objective, the Department should revise the BIC Exemption to include a single condition regarding reasonable compensation, and to use the same, well-understood standard that applies under IRC section 4975(c)(2). Specifically, no more than reasonable compensation may be paid for the services provided to the investor.

RECOMMENDATION: Reasonable compensation should be defined in standard terms; the “total compensation” and “reasonable in relation to value” language should be deleted.

c) “Neutral Factors” to Justify Differential Compensation

Layering on to its vague “reasonable compensation” language, the BIC Exemption requires firms and representatives to warrant that their compensation practices will not “tend to encourage” violations of a best interest standard. Again, in spite of the Department’s stated intention to preserve current business models, the BIC’s cumulative effect may be to force firms to eliminate any differential compensation or third-party compensation arrangements.

The Department suggests five examples that it claims provide support for variable compensation structures. However, none is practicable to implement. Two of the examples are level-fee structures, and one requires independent computer models. Notably, despite querying others in the industry, we are aware of no company that offers a 408(g) computer model advice arrangement. We believe that is because 408(g) arrangements are impractical, which in turn reflects that it is error for the Department to base the rule in part upon projections about computer-based tools that do not currently exist and have not been shown to be feasible. The fourth option is a compensation system based on “neutral factors,” such as the time and effort involved in selling a product, and the fifth suggests arrangements designed to “align the interests” of the representative with the interests of the investor. Though the fourth and fifth options ostensibly permit variable compensation, it is unclear how either could be implemented in a way that would give the firm any certainty that its practices comply with the exemption. Specifically, it is unclear how fee differences could be supported by “neutral factors” or under what circumstances the representative’s interests could align with those of his or her client. With respect to the former, a firm has no ability to control what the Department, or state courts, may consider to be a “neutral factor”, particularly when prices are set by third-party manufacturers based upon market factors. We find it unlikely that a firm would offer an advice arrangement in reliance on the exemption, such as a commission schedule that differs between mutual funds and annuities, in the absence of certainty that its variable pricing meets the neutrality requirement. With respect to the second, no guidance is provided as to how a firm is to align the representative’s interests with those of the investor where fee differences exist. It is also unclear, from a compliance perspective, how either of these standards could be administered and supervised in practice. Without this certainty, the liability risks and the prohibited transaction penalties for failure to comply are too great for a firm to proceed under the BIC Exemption.

We request that the Department provide clarification and guidance, including a meaningful example, regarding how and under what circumstances a firm and its representatives can receive variable compensation under the BIC Exemption. We request that the Department

clarify that variable commission-based fee arrangements are permitted, so long as the firm discloses the compensation to be received and any material conflicts of interest, and receives no more than reasonable compensation.

Adopting alternate methods of compensation, such as those included in the Department's five examples, would require a complete structural overhaul of the forms in which retirement assets are commonly distributed to consumers. At least with respect to mutual funds and variable annuities, most broker-dealers do not themselves set the price of the third-party products they sell, nor do they have the negotiating power to require the providers to uniformly price their products. In any event, we question whether an effort to level fees would pass anti-trust scrutiny. Regardless, the Department's five suggestions would ultimately lead to inferior models of delivering investment advice, particularly to middle-income investors who have smaller accounts and trade infrequently.⁴⁷

RECOMMENDATION: The Proposed Rule should be revised to expressly allow for differential compensation among products and asset classes; the “tend to encourage” language should be deleted.

5. Disclosure Obligations

In addition to the contract requirements, the BIC Exemption imposes no less than three new onerous investor and public disclosure obligations. These disclosure requirements will not only burden the industry with added costs and compliance risks, but will also overwhelm and confuse clients with yet more documents and information to review and digest, while providing few benefits over the disclosures already required to be provided under the federal securities laws, state insurance regulations, and other applicable rules.

a) Point-of-Sale Disclosures Are Potentially Harmful to Client Decisions

First, prior to an investor's purchase of a recommended asset, the representative must provide the investor a detailed chart setting out the “total cost” of the proposed investment over periods of one, five and ten years in actual dollar amounts. The “total cost” for each recommended asset must include its acquisition cost such as loads, commissions, mark-ups and account opening fees, ongoing fees and expenses such as mutual fund expenses, and disposition costs such as surrender charges and back-end loads. All of this will require forward-looking assumptions about holding periods and the investment's performance. While we understand that

⁴⁷ See, e.g., Staff of the U.S. Securities and Exchange Commission, Study on Investment Advisers and Broker-Dealers, at 152 (Jan. 2011), available at <https://www.sec.gov/news/studies/2011/913studyfinal.pdf> (stating that investors may face increased costs if the broker-dealer exclusion were eliminated, such as where commission-based accounts would incur lower costs compared to fee-based account due to infrequent trading); NASD Notice to Members 03-68, Fee-Based Compensation (Nov. 2003) (reminding members that fee-based accounts must be appropriate for customers, considering among other things the cost of the account compared to alternative fee structures available, such as commission-based accounts); Report of the Committee on Compensation Practices (Apr. 10, 1995), available at <https://www.sec.gov/news/studies/bkrcomp.txt> (noting commenters' views that fee-based accounts can pose higher costs for small and low-activity accounts).

the Department intends for this disclosure to clarify costs for the client prior to his or her investment, it will instead inject unnecessary complexity and slow transactions. Further, effective investment conversations often result in multiple proposals reflecting the iterative nature of good dialogue. A broker-dealer will need to provide a new chart with respect to each potential asset a client may want to consider. Much of this “total cost” data is actually held by their third-party product providers, and there may be a cost to the broker-dealer associated with developing each chart. Given that each client is likely to consider multiple investments, compilation of this information multiple times with respect to each ultimate transaction will be expensive and will also delay transactions. The resultant increase in transaction costs per investor will generally be passed on to clients, and may ultimately have the effect of shutting out small transactions from access to IRAs.

As importantly, we also are concerned that the upfront disclosure is likely to overwhelm the investor by focusing too much attention on costs and expense. In almost every case, stocks that are highly correlated to the market’s movements will look less expensive than a more stable asset such as a bond fund. The primary focus of an investment decision should instead be on the particular asset’s risk and return (net of expenses) profile and likelihood to achieve the investment goal. Moreover, the “total cost” information is likely to be overwhelming in respect of the summary prospectus, insurance disclosure, and other documents already required to be furnished to investors, all of which display fee and expense information. The new upfront disclosure is at odd with these, particularly where other regulators, for good reason, do not allow forward-looking estimates of performance.

Finally, as with other BIC requirements, we are concerned because the disclosure requirement is rife with ambiguities. For example, no guidance is provided as to what a firm is to do when the precise investment amount is not known, such as in the course of a rollover. Similarly, because the information required to be disclosed is held by third parties that may change pricing at any time, and because these disclosures must be produced in real time at any time a representative proposes an investment to a client, this disclosure will be impossible to perfect, and the Proposal builds in no margin for error or correction regime (other than a prohibited transaction).

RECOMMENDATION: The required point-of-sale disclosure should be a concise and easy-to-read document that presents in a standardized, rather than individualized, format solely that information required in a summary prospectus expressed as percentages and should include a mechanism to correct inadvertent or *de minimis* errors without penalty.

b) Annual Disclosures Will Not Aid Investors

Second, a new annual disclosure must be made to investors, within 45 days after the end of each year. The annual disclosure must include a list identifying each asset purchased or sold during the applicable year and the price at which it was purchased or sold. It must also include a statement of the total dollar amount of all fees and expenses paid by the investor or the IRA, directly and indirectly, with respect to each asset, as well as a statement of the total dollar amount of all compensation received by the representative and the firm, directly or indirectly, from any party as a result of each asset. The Department provides no guidance as to what is

meant by “directly or indirectly,” nor does it explain the need for the very short time of 45 days allowed for firms to compile the required information.

Our concerns about this annual disclosure requirement are numerous. First, the account transaction list duplicates information that is already reported to clients by the account custodian under SEC and FINRA rules, and the Department did not align the timing of this disclosure with the timing of SEC- and FINRA- mandated disclosures. Second, other information now required to be disclosed annually, such as fees and expenses attributable to each transaction, is duplicative of information the client has received at point-of-sale. And like the point-of-sale disclosure, such information should be standardized and permitted to be provided by way of percentage costs rather than individualized total dollar costs. Third, some information required to be reported by the firm is in fact held by the product manufacturer. Distributor broker-dealers simply do not have the required data. For example, most broker-dealers will not know the total dollar amount that an IRA paid to a third-party annuity company over the applicable period. Finally, while the fees and expenses are relevant to an investor, the share of those fees that the firm or the representative is being paid is not.

Like the upfront disclosure, the proposed annual disclosure is more likely to overwhelm than aid our clients. We do not believe the information would provide significant meaningful information to investors beyond what is currently provided on trade confirmations, account statements, and other disclosures. Because these information reports have not previously been required by any regulator, aggregating the data and presenting the reports will require an expensive systems build-out to be able to track each individual representative’s compensation with respect to each particular client’s accounts. Further, much of the required information will be costly to acquire, as it is held by third-party intermediaries. The exemption provides no guidance or safe harbor to apply in a situation where required information cannot be obtained in a timely manner from the relevant intermediary, even though a failure to make a timely disclosure would technically cause the firm to fail to qualify for the BIC Exemption. As a result, like the upfront disclosure, the excessive costs and risks of compliance likely will drive firms upscale.

RECOMMENDATION: The annual disclosure is duplicative of the point-of-sale disclosure and other disclosures made by product manufacturers and custodians under SEC and FINRA rules. It should be removed as a condition of the exemption.

c) Web Page Disclosures Will Cause Firms to Avoid Reliance on BIC Exemption

Finally, the Proposed Rule requires a financial institution availing itself of the BIC Exemption to maintain a web page in machine-readable format showing all “direct and indirect” compensation payable to the representative, firm, or other affiliate, with respect to each asset that an investor is able to purchase, hold or sell through the representative and that has been purchased, held or sold in the last year, along with the source of the compensation and how it varies within and among assets. This requirement seems to include every insurance company separate account, every mutual fund by share class, and every annuity contract. It would require, according to the preamble (though unclear from the proposed regulation itself), a quarterly

review of product and fee changes. Moreover, the website would make publically available personal information about representatives' compensation, which could conflict with state law privacy obligations. It likewise would make publicly available privately held competitive information, the disclosure of which would conflict with contractual obligations to third parties.

This massive web-based disclosure undertaking would be very difficult and costly for us to develop, implement and administer. It is highly unlikely that we could build out the technology in the eight months the Department has allowed for implementation. Nor do we believe that it will provide any value to members of the public, beyond providing an avenue for plaintiff's lawyers to make uninformed comparisons of fee practices between companies. We also have concerns that this information would be used to make unwarranted critiques of individual representatives, which likely would be based solely upon portfolio returns without regard to all of the factors that appropriately go into selection of a portfolio, or that investors are free to decline to follow with regard to their representative's recommendations. Moreover, we are deeply concerned that data mining companies will be able to extract proprietary information about our strategies that could unjustifiably hamper our competitive position in the market for financial services.

Again, notwithstanding the impracticality and cost, failure to satisfy any aspect of this website disclosure requirement, like each of the other BIC Exemption requirements, would trigger a wave of prohibited transactions. The resultant risk of strict liability penalties and participant lawsuits likely will cause firms to restructure the modes in which they sell IRAs and qualified plans to the public so as not to be subject to the need to satisfy the BIC Exemption.

RECOMMENDATION: Because the web page disclosure on its own will preclude the use of the BIC Exemption, it should be removed as a condition of the exemption. To the extent a firm is willing to attempt to comply with the BIC Exemption despite this requirement, the Department must allow more than eight months for development and implementation of a system to satisfy this disclosure requirement, and must include a mechanism to correct inadvertent or *de minimis* errors without penalty.

6. *Department's Data Request and Recordkeeping Obligations*

Adding to the burden, the BIC Exemption requires firms to store and maintain, for six years, a host of information that is subject to the request of the Department. This information includes: the identity and quantity of each asset purchased, sold or held; the aggregate dollar amount invested or received and the cost to the investor for each asset bought or sold; the cost incurred by the investor with respect to each asset; all revenue received by the firm and its affiliates with respect to each asset; the identity of each revenue source and the reason for payment; and at the investor or account level, the identity of the representative along with the quarterly value of the portfolio and inflow and outflows of cash with respect to the portfolio. The firm is further required to maintain records demonstrating that the conditions of the BIC Exemption have been satisfied. Each firm must be prepared to make this information available to the Department within *six months* from the date of a request. Further, the firm must make its records unconditionally available to investors and other members of the public for examination.

Finally, the Department makes these detailed recordkeeping requirements a condition of satisfying the BIC Exemption, without any relief for inadvertent errors.

We do not understand the need to provide this data to the Department with regard to IRA accounts over which it has no enforcement authority. By extending a form of audit authority to members of the public, the Department has effectively delegated enforcement to the plaintiff's bar. The Department fails to address the very serious privacy and security risks that acquisition, maintenance and distribution of such detailed personal financial information entails. Moreover, we do not have a system today that is capable of collecting, organizing or maintaining this massive volume of information. Nor should we be expected to have such a system, as this volume of information has never before been required, nor are we in possession of all of the required data. We expect that building such a system would take far more time – several years – and would be at a far greater cost than projected by the Department. We do not see any benefit to consumers from this requirement.

RECOMMENDATION: Records should not be required to be publicly disclosed, and these onerous recordkeeping requirements should not be a condition of relief with regard to the BIC Exemption.

7. *Class Action Waiver*

The BIC Exemption prohibits the contract from containing a provision whereby the investor “waives or qualifies its right to bring or participate in a class action or other representative action in court” against the representative or its firm.

The requirement to contractually warrant compliance with the Impartial Conduct Standards, the publication of the broker-dealers compensation grids in machine-readable format on a public website, and the prohibition against a class action waiver, taken together, seem designed to invite class action enforcement, in the form of breach of contract claims, against broker-dealers that have taken advantage of the BIC Exemption to maintain differential compensation they believe is justified based on neutral factors. Unfortunately, we believe that trial lawyers will simply mine the website to identify differential compensation structures, and then file class action “strike suits” alleging breach of the warranty that compensation practices do not “tend to encourage individual Advisers to make recommendations that are not in the Best Interest of the Retirement Investor.” Even if a firm has reasonable arguments to substantiate its differential compensation, due to the enormous costs of protracted litigation, the pressure to settle these cases, rather than to incur the cost to fight and prevail, will be enormous. We believe that this reason alone is sufficient to deter most firms from attempting to operate under the BIC Exemption.

Although we focus in the body of this letter on the practical ramifications of the Proposal on our industry and our clients, rather than on the scope of the Department's authority and conflicting law, we note that the Department lacks the authority to ban class action waivers in connection with arbitration agreements. This point is further addressed in the legal memorandum prepared by Gibson, Dunn and Crutcher that is attached as Appendix 6.

RECOMMENDATION: The Department should not, and lacks authority to, ban waivers in connection with arbitration agreements.

8. *Applicability Date Is Far Too Short*

As drafted, the Proposal allows firms eight months from the final rule date to implementation to make the operational, supervisory, technological and structural changes it requires. This period is far too short. As discussed below, implementation of the rule and the BIC Exemption would be extremely time-consuming and costly. Eight months is simply not enough time to accomplish the wholesale restructuring of our business models that the Proposed Rule would require.

RECOMMENDATION: The applicability date should be lengthened to three years from eight months.

B. *Costs of Compliance with the BIC Exemption Make Serving Small Accounts Impracticable*

The Rule's many requirements would command substantial time and resources to develop and implement. For example, the BIC Exemption would require firms to build and test a public website that needs to be updated and tested quarterly. Moreover, contracts would have to be prepared for new and existing clients, new systems would have to be developed and integrated (in some cases with third parties) to create and manage new disclosures, and compliance policies and procedures would need to be updated. At our firm alone, over 80,000 U.S. representatives would need to be trained to comply with the Proposal. We expect the increased costs associated with compliance with the BIC Exemption to have a direct impact on our ability to provide IRAs for the smaller investments that are typical of many of our clients.

To assist in our understanding of the operational impact and cost of complying with the Proposed Rule and its exemptions, Primerica participated in an industry working group of over forty financial institutions impacted by the Proposal. The group, which was organized by Deloitte & Touche LLP ("Deloitte"), produced the report attached here as Appendix 2. The working group firms were asked to analyze the systems and process changes they would make to comply with the Proposal, and also to assess the resources required to make these changes. Without a doubt, there was agreement that firms would need to make "substantial investments and transformations to business, compliance and operational frameworks."⁴⁸ The firms also recognized that the Proposed Rule would require a considerable overhaul to existing systems impacting controls, supervision, surveillance, data collection and data management. As the Proposal affects only retirement accounts, firms would need to bifurcate their field and back office systems and processes, as well as supervisory and marketing materials, to accommodate differing regulatory requirements for retirement and non-retirement accounts. In many cases, the group recognized that technology solutions to capture some of the required data do not currently

⁴⁸ Deloitte & Touche LLP, *Report on the Anticipated Operational Impacts to Broker-Dealers of the Department of Labor's Proposed Conflicts of Interest Rule Package* (July 17, 2015), at 14, available at <http://www.sifma.org/workarea/downloadasset.aspx?id=8589955444>.

exist, and would require effort and time to develop. Likewise, technology to document, substantiate, retain and maintain a fiduciary standard and reliance on the exemption would have to be developed, as it does not currently exist.

Below is an exhibit from the Deloitte report illustrating the operational impact of areas where build-out of systems, processes, controls and oversight are required to meet the BIC Exemption disclosure requirements.⁴⁹

		Potential Impacts (May Not Be All-Inclusive)				
		System Build to Collect	Conversion to Dollar Amount	Implementation of Process	Implementation of Controls	Implementation of Oversight
Potential Required Data Points	Disclosures					
	Initial Transaction Disclosure	Acquisition Costs of Transaction		X		X
		Ongoing Costs of Product	X	X	X	X
		Disposition Costs for 1-, 5- and 10-year Periods	X	X	X	X
		Reasonable Assumptions about Investment Performance	X	X	X	X
	Annual Disclosure	List of Assets Bought and Sold During the Year (Along with Sales Price)	X	X	X	X
		Total Dollar Amount of Direct Fees Paid by the Investor with Respect to Assets Bought, Sold and Held	X	X	X	X
		Total Dollar Amount of Indirect Fees Paid by the Investor with Respect to Assets Bought, Sold and Held	X	X	X	X
		Total Dollar Amount of Expenses Paid by the Investor with Respect to Assets Bought, Sold and Held	X	X	X	X
		Total Dollar Amount of Direct Compensation Received by the Investment Professional with Respect to Assets Bought, Sold and Held	X	X	X	X
		Total Dollar Amount of Indirect Compensation Received by the Investment Professional with Respect to Assets Bought, Sold and Held	X	X	X	X
		Total Dollar Amount of Direct Compensation Received by the Financial Services Firm with Respect to Assets Bought, Sold and Held	X	X	X	X
		Total Dollar Amount of Indirect Compensation Received by the Financial Services Firm with Respect to Assets Bought, Sold and Held	X	X	X	X
	Webpage	Direct Compensation Payable to the Investment Professional for Assets Bought, Sold and Held by an Investor in the Last 365 Days	X	X	X	X
		Indirect Compensation Payable to the Investment Professional for Assets Bought, Sold and Held by an Investor in the Last 365 Days	X	X	X	X
		Direct Compensation payable to the Financial Services Firm for Assets Bought, Sold and Held by an Investor in the Last 365 Days	X	X	X	X
		Indirect Compensation Payable to the Financial Services Firm for Assets Bought, Sold and Held by an Investor in the Last 365 Days	X	X	X	X
		Direct Compensation Payable to Any Affiliates for Assets Bought, sold and Held by an Investor in the Last 365 Days	X	X	X	X
		Indirect Compensation Payable to Any Affiliates for Assets Bought, Sold and Held by an Investor in the Last 365 Days	X	X	X	X
		Variations in Compensation Within and Among Assets	X	X	X	X
	Recordkeeping					
	Intention to Rely on Exemption					
	Inflows					
	Outflows					
	Holdings					
	Returns					
	Substantiation that Conditions of the Exemption Were Met					

⁴⁹ Deloitte, *Figure 2.4*, at 19.

Without a clear understanding of the operational, systems and technological changes that the rule would require, the Department estimated that start-up compliance costs for a large broker-dealer would be a mere \$5 million. This estimate is off the mark. Deloitte surveyed a diverse mix of firms and grouped them based on net capital. Deloitte reports the firm's estimated start-up and ongoing maintenance costs of compliance with the rule as follows:⁵⁰

Firm Size	Number of Firms in Industry per DoL	Mean Start-Up Costs Per Firm	Mean Ongoing Costs Per Firm
Large	42	\$34,257,289	\$8,757,222
Clearing		\$24,217,800	\$5,265,000
Self-Clearing		\$37,125,714	\$9,755,000
Medium	137	\$18,862,337	\$4,032,935
Clearing		\$33,516,685	\$4,254,676
Self-Clearing		\$15,198,750	\$3,977,500
Small	2,440	\$ 5,563,804	\$4,255,210
Introducing		\$ 7,220,706	\$6,132,815
Self-Clearing		\$ 2,250,000	\$ 500,000

Using the Department's own estimate of the number of large, medium and small firms, the start-up costs for large firms across the industry will be \$1.4 billion. The start-up costs for medium and small firms will be \$2.5 billion and \$13 billion, respectively, for a total of approximately **\$17 billion**. Ongoing compliance costs for the industry as a whole are projected to be approximately **\$11 billion annually**. The Department has vastly understated the cost of compliance.

Moreover, the sums reported above are direct costs of the proposal. Attached as Appendix 3 is a report by Compass Lexecon regarding the costs benefit analysis performed by the Department. Compass Lexecon determined that the Department's economic analysis of the Proposed Rule "grossly overstates the benefits it purports to measure".⁵¹ It further concluded that the Department failed to properly analyze the unintended consequences of the Proposal that can serve to substantially increase costs, thus rendering the Department's conclusions as to the costs of the Proposal to be fatally flawed. The authors state:

With respect to the potential costs, the DOL's analysis relies upon a number of vague and unsupported assumptions which call into question its reliability. For example, the DOL only offers a dollar cost estimate relating to the most obvious categories of direct costs. The DOL routinely speculates that its

⁵⁰ Deloitte, *Figure 1.10* at 15.

⁵¹ Compass Lexecon, *An Evaluation of the Department's Impact Analysis of Proposed Rules Relating to Investment Advisor Fiduciary Status* (July 20, 2015), at ¶ 2.

estimate is likely overstated but ignores or dismisses additional costs associated with many possible unintended consequences of the proposed amendments. Examples of unintended consequences include the possibility of higher investor paid fees and lower overall savings by IRA investors.⁵²

Importantly, the authors note that the Department failed to acknowledge that the costs imposed on advisers and advisory firms operating in the industry will likely be passed on to investors in the form of higher fees. For example, the authors state that these higher costs can lead firms to exit certain segments of the industry, leading to weakening competition that could otherwise drive down fees. As there likely will be less competition for IRA investors with account balances below \$25,000, fees to these customers may increase.⁵³

Likewise, the Department too readily dismisses the potential for reduced savings in tax-preferred IRAs. Compass Lexecon concludes:

Though lengthy, the DOL’s “Regulatory Impact Analysis” provides no reliable estimates of the costs and benefits of the proposed amendments, and as a consequence, does not justify the costs likely to be incurred by market participants (including IRA investors). Among other limitations in the DOL’s benefits analysis, it improperly applies the results of the academic literature upon which it relies and, as a consequence, likely grossly overstates the benefits of the proposed amendments. The DOL’s cost estimate is reminiscent of the old joke about the drunkard who looks for his lost keys under the streetlamp because that’s where the light is. The DOL only attempts to quantify the most obvious and direct costs of the proposed amendments, while dismissing or overlooking a wide range of potential unintended consequences that could dramatically increase the costs. The history of regulation provides strong reason to be skeptical of the DOL’s assumption that the proposed amendments would have no costly unintended consequences.⁵⁴

Equally troubling is a report prepared by NERA Economic Consulting (“NERA”), attached as Appendix 3, which draws a direct link between the excessive costs of compliance with the Proposal and the ability of firms to make IRAs available to small-dollar investors. NERA reviewed account level data of over 69,000 IRA accounts from six firms, ranging from 2012 through the first quarter of 2015. From this data, they determined that 40.49% of the accounts could not be maintained under the Proposed Rule. As a result, NERA stated that, based upon a “conservative estimate” of the minimum balance for advisory accounts being \$25,000:

If we were to take at face value the DOL’s methodology in the 2011 cost-benefit analysis discussed above, **the new fiduciary standard would cause a loss of**

⁵² Compass Lexecon, *Comment to the Department of Labor on a Proposed Rule Regarding the Fiduciary Status Under ERISA* (July 20, 2015), at ¶ 5.

⁵³ *Id.* at ¶ 32.

⁵⁴ *Id.* at ¶ 49.

access to professional advice for 40.49% of retirement account holders. This would result in an aggregate cost of \$114 billion x 40.49% or about \$46 billion per year.⁵⁵

(Emphasis added.)

NERA additionally identifies the costs of investors losing access to advice, largely as set forth in a 2011 study by the SEC staff (the “SEC 913 study”). In particular, NERA notes that brokers are expected to convert existing accounts from commission-based accounts to fee-based accounts in order to respond to the new requirements placed on commission-based accounts. The likely impact would be higher costs to investors who buy and hold. Likewise, broker-dealers may unbundle their services and provide them separately through affiliates or third parties, generating additional administrative costs. The primary concern, as expressed by the SEC 913 study, is that the cost and availability to retail investors of accounts, products, services and relationships with broker-dealers “*could inadvertently be eliminated or impeded.*”⁵⁶

This high cost of compliance will have far broader consequences, by affecting the decisions firms make in responding to the Proposal. As a simple example, if a firm is anticipating the cost per retirement account to increase by a significant dollar amount, it is within reason that the firm will set account minimums to preclude accounts that would no longer be profitable or direct low-dollar investments to taxable accounts. Equally likely, firms will pass these very real costs on to clients. In some cases, firms may choose to exit the retirement market. In each case, the increased cost can be expected to be felt most severely by middle-income consumers where margins are lowest.

C. *Self-Help Online Investment Options Will Not Offset the Harm of the Proposed Rule to Middle-Market Investors*

Many of the middle-income families we serve are prompted to save because we encourage or “nudge” them. As noted, we believe that our representatives are an integral part of clients achieving their retirement objectives, through face-to-face education and assistance and access to an appropriate range of reasonably-priced products with transparent fee structures. Without this sort of personal interaction, many of our clients are likely to forgo saving at all. If cut off from responsible, well-equipped financial professionals, even those who have the confidence to go it alone would be left vulnerable to the temptations inherent to human nature: chasing returns and attempting to time the market, and moving resources to inappropriate, low-risk, low-yield assets (*i.e.*, savings accounts) even with many years to go until retirement. Nonetheless, this benefit – and the potential loss to middle-income savers from lack of personal assistance – is ignored by the Department in its analysis of the costs and benefits of its Proposed Rule.

⁵⁵ NERA, *Comment on the Department of Labor Proposal and Regulatory Impact Analysis* (July 20, 2015), at 17.

⁵⁶ *Id.* at 28.

In fact, the Department at times has responded to the Proposed Rule's potential to decrease access to help for lower-wealth households by suggesting that self-help online investment tools may even be preferable.⁵⁷ However, these self-help alternatives are not the solution. Studies consistently confirm that the percent of workers and retirees comfortable obtaining assistance from financial professionals online is quite low. In its 2012 study, the EBRI put this figure at just 10 percent.⁵⁸ In a similar 2015 study, the EBRI reported that the majority of workers (74%) are not interested in obtaining investment education online.⁵⁹ Likewise, a recent Gallup Poll found that less than one in three is very comfortable using online technology for investing.⁶⁰ Even younger generations with greater familiarity with technology strongly prefer personal interactions when it comes to retirement investing. According to a recent survey performed by Greenwald and Associates ("Greenwald"), more than twice as many younger workers want traditional, in-person education.⁶¹ Greenwald likewise asserted that in-person education boosts savings.⁶² Further, a self-help or robo-solution will not provide post-transaction assistance in the same way that an individual financial professional can.

Equally troubling, nearly 20% of U.S. adults, or nearly 60 million Americans, remain without access to online investment options, as internet adoption has leveled off in recent years.⁶³ These are predominantly lower-wealth families, minorities and English-as-a-second-language individuals, yielding some disturbing differences among internet users that should be concerning to policymakers. Internet usage by Hispanic and African-American households still lags behind

⁵⁷ InvestmentNews; DOL Secretary Perez touts Wealthfront as a paragon of low-cost, fiduciary advice, June 22, 2015. ("When he appeared at a [June 17 congressional hearing](#), Mr. Perez mentioned Wealthfront, an online investment adviser, at least three times. A day later, he tweeted a photo of himself and Wealthfront Chief Executive Adam Nash at the Wealthfront office.")

⁵⁸ EBRI 2012 Retirement Confidence Survey, available at http://www.ebri.org/pdf/surveys/rcs/2012/EBRI_IB_03-2012_No369_RCS.pdf ("[J]ust 10 percent of [workers and retirees] say they are comfortable obtaining advice from financial professionals online."), at 1 (last bullet point).

⁵⁹ EBRI 2015 Retirement Confidence Survey, available at http://www.ebri.com/pdf/surveys/rcs/2015/EBRI_IB_413_Apr15_RCS-2015.pdf ("While just 4 percent of workers report being very interested in obtaining investment education and advice online, 22 percent say they are somewhat interested. Nevertheless, the majority of workers are not too (26 percent) or not at all (48 percent) interested."), at 24.

⁶⁰ Gallup Poll, "U.S. Investors Opt for Human Over Online Financial Advice: Just one in three are very comfortable using online technology for investing," available at <http://www.gallup.com/poll/174851/investors-opt-human-online-financial-advice.aspx>.

⁶¹ Matthew Greenwald Survey, "Younger Workers Want In-person Education," available at <http://www.benefitnews.com/news/retirement/younger-workers-want-in-person-education-2746146-1.html> ("Despite their familiarity with technology, the Generation X and Generation Y populations prefer traditional means when it comes to retirement education.").

⁶² *Id.*

⁶³ "The 60 million Americans who don't use the Internet, in six charts," available at <https://www.washingtonpost.com/blogs/the-switch/wp/2013/08/19/the-60-million-americans-who-dont-use-the-internet-in-six-charts/>.

white and Asian households.⁶⁴ There is also a notable geographic gap among rural versus urban households, and there are more non-users in the Southeast. Expectedly, household wealth is directly linked to usage. Up to 40% of Americans do not have broadband at home,⁶⁵ presumably where self-help investing is most likely to occur.

This potential financial advice wealth-gap has not gone unnoticed. During the recent House Education and Workforce Committee hearing entitled “Restricting Access to Financial Advice: Evaluating the Costs and Consequences for Working Families and Retirees,” Rep. Federica Wilson (D-Fla.) expressed her concern, stating: “Technology is very intimidating to many people in our communities. For people who don’t have access to technology, it is intimidating. So let’s . . . make sure that we don’t eliminate them from the equation because we thrust them into a pit that they don’t quite understand.”⁶⁶

Also notable is that many of the current online investment providers either require investment minimums that are not attainable for many first-time savers, or offer only discretionary services, or both. Of similar concern are the minimalistic gating questions posed by the online providers. The providers’ technology takes responses to these questions to compute specific investments for the clients. For example, Wealthfront asks five questions: (1) “What is your current age?”; (2) “What is your annual after-tax income?”; (3) “What is the total value of your cash and liquid investments?”; (4) “When deciding how to invest your money, which do you care about – maximizing gains, minimizing losses, or both equally?”; and (5) “The global stock market is often volatile. If your entire investment portfolio lost 10% of its value in a month during a market decline, what would you do – sell all of your investments, sell some, keep all, or buy more?” Absent from these are questions regarding short-term liquidity needs, life-cycle events, employment, short- and long-term goals, need for qualified retirement savings vs. taxable investments, and a host of others personal to each family. First, in our experience, our clients – often first-time savers – would be stymied by some of these questions. Second, we are puzzled why the Department seems to believe computer-generated decisions calculated from such a generic questionnaire to be *de facto* in a consumer’s “best interests”.

Even more alarming, families seeking self-help advice are susceptible to being misdirected to “bad advice”. A simple search for investment help online can easily lead to internet message board commenters and affinity fraudsters enticing middle-income Americans to cash out their savings and invest in speculative, undiversified ventures without raising the issues of tax penalties and lost tax-advantages, and recklessly suggesting returns that would persuade an overwhelmed investor to disregard tax considerations in any event. Many American families are

⁶⁴ Pew 2012 Research Report “Digital Differences,” available at <http://www.pewinternet.org/2012/04/13/digital-differences> (“20% of U.S. Adults Do Not Use the Internet... Senior citizens, Spanish-speaking adults, the disabled, the less educated, and lower earners are among the least likely to go online. 40% of Americans do not have broadband access at home.”).

⁶⁵ *Id.*

⁶⁶ House Education and Workforce Committee hearing entitled “Restricting Access to Financial Advice: Evaluating the Costs and Consequences for Working Families and Retirees” (June 17, 2015), Final Transcript, Panel 1 at 42.

rightly overwhelmed by the mass of “investment information” on the internet, and many are paralyzed to act on their own.

We fervently believe that while technological models are well-designed to augment the sales process (calculators, Monte Carlo simulators, etc.) and to suit the needs of some, it is imprudent to believe that they will provide the “band-aid” required to stop the leakage caused by a Proposed Rule that has the effect of cutting off personal service to small accounts.

D. The Proposed Rule Will Effectively Result in a Tax on the Middle Class

As indicated by NERA, a likely outcome of the Proposed Rule is that nearly half of middle-income consumers – those with amounts to invest below advisory account minimums – will be left with limited options to save in an IRA.⁶⁷ For many families this may result in decisions to spend rather than save. As noted above, for those who choose saving, only a tenth can be expected to use online investment options. The others may forgo the tax benefits available to IRAs and instead invest through taxable accounts in order to continue their relationship with their chosen financial professional. Obviously, this would be to their detriment, and contrary to Congressional intent of encouraging retirement savings.

In order to understand the effect of such leakage away from IRAs and into taxable savings vehicles, Compass Lexecon was asked to measure the impact on accounts with balances below \$25,000, a conservative minimum account balance for advisory accounts. The Compass Lexecon report is attached as Appendix 5. As explained in detail in their letter, Compass Lexecon quantified the loss to investors who would have opened IRAs but, as a consequence of the Proposal, instead open taxable savings accounts. In the analysis, Compass Lexecon looked at median taxpayers ranging in age from 30 to 45 years when they make their initial investment and modeled representative annual or biannual contributions until retirement. This age range and the contribution amounts are based upon EBRI reports of average annual IRA contributions and fairly represent the demographic age at which our clients commonly begin their IRAs with us. Compass Lexecon concluded that the loss associated with moving from an IRA to a taxable savings account is large. In the median case of a 30-year-old investor who starts an IRA and contributes annually, Compass Lexecon determined:

“The median outcome of our model for this investor involves an effective average tax rate on savings (relative to a totally untaxed account) of 23.8 percent for a Roth IRA and 15.0 percent for a traditional IRA, whereas the effective average tax rate on savings for the same investor making the same investment, but in a taxable savings account, is 38.7 percent. In other words, the taxpayer in this case would see his effective tax rate rise by 62.6 percent relative to a Roth IRA, and 158.0 percent relative to a traditional IRA if the DOL’s proposed amendments caused him to open a taxable savings account.”⁶⁸

⁶⁷ NERA, *Comment on the Department of Labor Proposal and Regulatory Impact Analysis*, at 28.

⁶⁸ Compass Lexecon, *Tax Consequences to Investors Resulting from Proposed Rules Relating to Investment Adviser Fiduciary Status* (July 20, 2015), at ¶ 5.

The Compass Lexecon report goes on further to conclude that while the Proposal's impact varies across investors who start saving at different ages:

"The median effective tax increase due to the DOL's proposed amendments varies across investors who start saving at different ages, but in any case, the tax increases remain very substantial, with the median never below 32.9 percent. Therefore, to the extent that the DOL's proposed amendments lead a substantial number of investors to open taxable savings accounts instead of IRAs, the amendments would in essence constitute a sizable tax increase on many Americans' retirement savings."⁶⁹

Compass Lexecon put this anticipated higher effective tax rate in perspective by estimating the number of years of retirement that an investor can fund at a desired level of annual retirement income. They estimated that the tax impact would reduce the number of years funded at retirement by about 2.7 years or 4.3 years, relative to a Roth IRA or a traditional IRA, respectively. This can be a meaningful difference for our clients. Additionally, Compass Lexecon roughly calculated that over the potentially 7.0 million existing households with IRAs under \$25,000, the effective tax increase could result in a total reduction in retirement savings of between \$147 billion and \$372 billion.⁷⁰

Compass Lexecon acknowledges that while account values diminish substantially for investors who either wait until later ages to begin an account or who do not contribute every year, IRAs still have substantial tax benefits in all cases, not surprisingly.

E. Fiduciary Definition Is Not Uniform Across Regulators

We are also concerned that the Department's lack of substantive coordination with the regulators that have overseen the financial industry for decades (and, in some cases, a century or more) will result in fiduciary standards that are far from uniform, and that will only increase investor complexity and hamper efficient and successful financial planning and implementation of investment objectives. The input of these regulators (including the SEC, FINRA, and the federal banking regulators, among others) would help the Department gain a fuller understanding of the financial services industry, its products, the conflicts firms and financial professionals face, and how these conflicts may be best addressed to protect investors, while minimizing complications and inefficiency. Over many more than forty years, these regulators (checked by federal court litigations) have developed clear fiduciary standards that are rooted in common law principles, but also are adapted to particular financial services' business models. The extensive learning of these regulators, as well as the SEC's current initiative to adopt uniform standards under Section 913 of the Dodd Frank Act, should inform and guide the Department's approaches to fiduciary standards in the Proposal. This is critical to minimize complexity and inefficiencies and to help ensure that investors can meet their retirement goals. We also note that the

⁶⁹ *Id.* at ¶ 6.

⁷⁰ *Id.* at ¶ 8.

Department is required to consider the cost of *cumulative* regulation when issuing its own regulations to ensure that they impose the least burden on society, consistent with the regulation's objectives.⁷¹

F. The Proposed Amendments to PTE 84-24 Will Have the Effect of Denying Important Annuity Products to Consumers

The Department's public statements regarding the Proposed Rule seem unduly focused upon whether variable annuities are appropriate for retirement investors.⁷² Specifically, the Department has suggested that variable annuity fees are too high relative to mutual fund fees. The Department's statements ignore that variable annuities typically come with benefits in addition to investment returns, and so it is not appropriate to compare them to mutual funds. For example, variable annuities may have both living and enhanced death benefits. These lifetime benefits are often critical to protecting the best interests of retirement investors.

The Department has proposed certain changes to the current class exemption covering sales of insurance products – Prohibited Transaction Exemption 84-24 (“PTE 84-24”). Specifically, the Department's Proposal excludes sales of variable annuities to IRA clients from coverage, and substantially limits relief for traditional forms of compensation from sales of variable annuities heavily relied upon by the industry, which could effectively restrict the sale of fixed and variable annuities entirely. In addition, the Department's proposed amendments do not provide grandfather protection for existing contracts that currently rely on PTE 84-24.

We understand that the Department has proposed that sales of variable annuities to IRA clients would be covered under the BIC Exemption, as opposed to PTE 84-24. As proposed, the BIC Exemption does not provide a practical pathway for firms to offer variable annuities if they also offer any other products, such as mutual funds, under the Impartial Conduct Standards, which may be read to prohibit non-level compensation. As discussed, the Impartial Conduct Standards seems to require level fees across product lines with the exception that variations may be justified based on “neutral factors.” As the Department is aware, variable annuities, like most products, are priced based on market factors. Are market factors “neutral”? The risk is too great. The unintended consequence may be the elimination of these investment options for retirement investors.

We see no reason for the Department to modify current relief under PTE 84-24. We urge the Department not to amend or partially revoke PTE 84-24. The Department should further study the use of annuities and their benefits to particular investors, and should properly measure the costs and benefits of disallowing traditional forms of compensation associated with annuities before amending the definition of “commissions” and effectively banning the sale of variable annuities to IRAs. Moreover, because the Department has also proposed to require firms and financial professionals to act in their clients' best interests, it would seem unnecessary to exclude sales of variable annuities from relief under PTE 84-24. Finally, our concerns about how it is

⁷¹ See also Exec. Order No. 13563, *Improving Regulation and Regulatory Review* (2011).

⁷² See House Education and Workforce Committee hearing transcript, *supra* at note 66, at 8.

generally not feasible to satisfy the BIC Exemption's conditions, particularly the Impartial Conduct Standards, would apply equally to sales of annuities.

RECOMMENDATION: PTE 84-24 should not be amended or revised.

IV. Legal Basis for the Proposed Rule and Exemptions

While we appreciate the Department's interest in protecting consumers' retirement savings and its role with respect to ERISA plans, we respectfully submit that the Proposed Rule and accompanying exemptions exceed the Department's regulatory authority.

We retained the law firm of Gibson Dunn & Crutcher LLP to address the legal basis for the Department's Proposed Rule. Attached as Appendix 6 is a comment letter setting forth a legal analysis of the Proposed Rule ("Gibson Dunn Comment"). In summary, the Department's Proposal will not withstand legal scrutiny for several reasons. First, the Department's definition of "fiduciary" is vastly overbroad and impermissible, and conflicts with the plain statutory text, the common law of trusts, and the language of the Advisers Act that Congress drew upon in codifying ERISA's definition of investment fiduciary. Second, the Department exceeds its authority in regulating the activity of broker-dealers with respect to IRAs. The Proposed Rule and BIC Exemption also exceed the Department's regulatory authority by attempting to create an enforcement scheme over IRAs. For these and other reasons, the Proposed Rule is improper and should be withdrawn.

V. Recommendations

The Department has stated its intention to preserve the existing revenue streams associated with commission-based accounts predominately used by IRA investors. Our comments are intended to help the Department understand that the Proposal fails because of its overly broad expansion of the definition of fiduciary, and the enormous complexity and burden of the BIC Exemption that was intended to preserve commission-based brokerage services. If the Proposal is finalized in its current form, companies like ours will have no choice but to restructure their businesses so as to avoid a need to rely on the BIC Exemption. This will likely result in an increased focus on serving affluent clients at the expense of middle-income savers. To the extent firms do provide services that fall under the BIC Exemption, they are likely to establish parameters for non-taxable accounts, which will have the effect of cutting off small investors from valuable retirement services and passing on the higher costs of compliance to consumers.

We therefore urge the Department to withdraw the Proposed Rule. If the Department nonetheless continues to believe that an expanded definition of "fiduciary" is necessary, we think it is critical that the Proposal be substantially revised. Specifically, and to summarize our recommendations above, an operational Proposal would allow for the following:

- A definition of "fiduciary investment advice" that is narrowed to make it clear that fiduciary status is based upon a mutual understanding or agreement that advice is individualized to the advice recipient, and is intended for the recipient's material

consideration.

- A meaningful seller's carve-out for retail investors that preserves their access to non-fiduciary investment assistance and the commission-based brokerage model.
- An investment education carve-out that:
 - Permits specific products to be identified so that useable and meaningful education and assistance can be provided to retail investors.
 - Incorporates FINRA guidance distinguishing recommendations from investment education within the context of rollovers and distributions.
- A workable exemption that preserves investor access to traditional commission-based brokerage services by:
 - Not requiring a contract until an account opening.
 - Not requiring "wet signatures" or that individual representatives be parties to the contract.
 - Expressly permitting a firm and its representatives to contractually agree to be a fiduciary, solely with respect to a transaction, without an ongoing fiduciary obligation to the client or the account.
 - Grandfathering existing accounts and all prospective transactions within them under the current definition of "fiduciary investment advice" rather than transitioning them to the exemption.
 - Eliminating the warranty requirements, and not requiring actual adherence to the Impartial Conduct Standards as a condition of the exemption.
 - Providing for a "best interest" standard that adheres to the FINRA formulation: the financial professional should provide recommendations that are in the "best interests" of the client and put the client's interest before his or her own.
 - Defining reasonable compensation in standard terms; the "total compensation" and "reasonable in relation to value" language should be deleted.
 - Expressly permitting differential compensation among products and asset classes.
 - Requiring a concise and easy-to-read, point-of-sale disclosure that presents, in a standardized rather than individualized format, solely the information required in a summary prospectus.
 - Eliminating the annual, website, and data record keeping requirements.
 - Permitting parties to waive class actions in connection with arbitration agreements.
- PTE 84-24 should not be amended or revised.
- An extension of the applicability date to three years after the publication of a final rule.

If combined with a narrower definition of "fiduciary investment advice," a seller's exception to the fiduciary advice definition that applies to retail investors (provided that adequate disclosures about the nature of the communications and products are made) and a broader exception to the fiduciary advice definition for investor education (including rollover education, provided the conditions of FINRA Notice 13-45 are met), a new best interest contract exemption

may indeed satisfy the Department's stated intention of protecting retail investors without threatening the existing business models that serve those investors well. This Proposal, however, does not satisfy that goal.

Overall, we believe that the Proposed Rule will harm rather than help middle-income retirement investors, no matter how long it takes to implement the Proposal. The added litigation and penalty risks will drive increased compliance costs and lead financial institutions and representatives to curtail the services they offer to middle-income investors.

We recognize that the Department believes serious issues exist in the broker-dealer industry. Nonetheless, the Proposed Rule is not the proper means for addressing those concerns, nor is the DOL Department the appropriate agency to do so. As discussed above, the fiduciary Proposal contains significant legal flaws, and given the number of open questions, and that the Proposal will affect over \$1.6 trillion in assets, we respectfully request that the Department either withdraw the Proposed Rule entirely, or revise it and re-propose it for additional comment.

We would welcome the opportunity to meet with appropriate personnel from the Department's Employee Benefits Security Administration and EBSA and the Office of the Solicitor to discuss these matters further.

We thank the Department for its efforts in this matter and we appreciate the opportunity to share our thoughts regarding this critical rule-making.

Sincerely,

A handwritten signature in black ink, appearing to read "Kara L. McKee". The signature is fluid and cursive, with a horizontal line extending from the end.

APPENDICES

1. **Oliver Wyman, *The Role of Financial Advisors in the US Retirement Market* (July 10, 2015)**
2. **Deloitte & Touche LLP, *Report on the Anticipated Operational Impacts to Broker-Dealers of the Department of Labor's Proposed Conflicts of Interest Rule* (July 17, 2015)**
3. **Compass Lexecon, *An Evaluation of the Department' Impact Analysis of Proposed Rules Relating to Financial Representative Fiduciary Status* (July 20, 2015)**
4. **NERA Economic Consulting, *Comment on the Department of Labor Proposal and Regulatory Impact Analysis* (July 17, 2015)**
5. **Compass Lexecon, *Tax Consequences to Investors Resulting from Proposed Rules Relating to Financial Representative Fiduciary Status* (July 20, 2015)**
6. **Comment Letter of Gibson Dunn & Crutcher LLP (July 20, 2015)**
7. **Comment Letter of Daniel Campagna**
8. **Comment Letter Joan Jones-White**
9. **Comment Letter Sarah Manley**
10. **Comment Letter Alex Franki**
11. **Comment Letter Thomas R. Pool**
12. **Comment Letter of Rita Huckle**
13. **Comment Letter of Shelly Rosen**
14. **Comment Letter of Jodie Orel**

APPENDIX 1

The role of financial advisors in the US retirement market

JULY 10, 2015

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About this report

There has been substantial public debate recently about the value of financial advice and the importance of financial advisors. Many people continue to believe financial advisors perform a critical service helping individuals and small businesses successfully navigate complex financial challenges. Others have sought to portray financial advisors as self-interested salesmen and saleswomen, who provide conflicted advice to sell high cost products. Against this background, Oliver Wyman was engaged to perform a rigorous investigation of the role of financial advisors in the US retirement market, and quantify differences in investing behavior and outcomes between advised and non-advised individuals.

In this report, Oliver Wyman focuses on understanding the impact of financial advisors on individuals saving for retirement and small businesses setting up and maintaining a workplace sponsored retirement plan. Through a combination of proprietary research with individuals and small businesses and analysis of unparalleled datasets from IXI (a division of Equifax), we found that advised individuals and small businesses are better off in many of the ways that matter most for superior investing outcomes.

The benefits financial advisors provide are now at risk. On April 14, 2015, the Department of Labor issued its Conflict of Interest rule proposal, a replacement for the Definition of the Term “Fiduciary” rule proposal withdrawn in September 2011. The new Conflict of Interest Rule proposal, like its predecessor, would greatly expand the range of conditions under which an individual who provides investment services would be subject to ERISA fiduciary rules. The new proposal goes further in some respects. It explicitly defines promotional services provided to IRA account holders and small businesses as advice subject to ERISA fiduciary rules. While many stakeholders are analyzing the technical details and implications, this study considers the impact on individuals and small businesses that use financial advisors. We conclude that the newly proposed rule, while well intended, would have significant negative consequences for many retail investors if implemented with regard to the availability and cost of retirement savings help and support.

Further details on our research sources and methodology

1. Proprietary research, including two surveys of 4,393 retail investors and 1,216 small businesses;
2. Two datasets provided by IXI Services representing approximately 20% (\$5.6 Trillion in 2013) of U.S. consumer invested assets on a household level and approximately 30% (\$9.7 Trillion in 2013) of U.S. consumer invested assets on

3. an account level, respectively. This data is broken into different types of investment holdings for specific age, income and wealth segments as well as between individuals with, and without, a financial advisor;
4. Widely available secondary data sources.

Analyses based on data from the Oliver Wyman Retail Investor Retirement Survey and IXI invested assets datasets have been controlled for factors such as income, age, and assets to ensure they are representative of particular segments of the US retail investor population. In addition, responses from the retail investor survey were further scaled based on the 2013 Federal Reserve Survey of Consumer Finances to produce a representative sample of US retail investors. Unless indicated otherwise, small businesses are defined as businesses with established payroll and up to 100 employees. For additional information regarding our approach and market research, please refer to the methodology section of this document contained in the appendices.

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Executive summary

Oliver Wyman's study of the role of financial advisors in the US retirement system draws upon proprietary surveys of more than 4,300 retail investors and 1,200 small businesses, datasets from IXL Services (a division of Equifax), representing approximately 20% of U.S. consumer invested assets on a household level and approximately 30% of U.S. consumer invested assets on an account level, to provide a unique window into the value financial advisors provide to small businesses and retail investors for their retirement savings and investments needs.

With fewer individuals covered by corporate pension plans and the future of social security uncertain¹, individuals are increasingly responsible for providing for their own retirement. Workplace-sponsored defined contribution (DC) plans offer significant tax and other advantages to foster increased retirement savings. Indeed, 84% of individuals began saving for retirement via a workplace retirement plan.² When available, they are often the primary vehicle for personal retirement savings. However, over 19 million people who work for businesses with fewer than 50 employees do not currently have access to a workplace retirement plan.

We found that financial advisors are often a key advisor to small businesses, helping business owners through the process of setting up a defined contribution plan for their employees. When a financial advisor is involved, small businesses with 10-49 employees are 50% more likely to set up a workplace retirement plan. In addition, micro businesses (1-9 employees) that work with a financial advisor are nearly twice as likely to set up a plan.

Recognizing the growing importance of workplace DC plans, there have recently been a number of innovations that have doubtlessly improved the retirement outcomes for millions of people, including automatic enrollment and rebalancing features, better default investment options and in-plan advice. Yet, in spite of these improvements, many individuals continue to under-save (the average default contribution rate for plans with automatic enrollment is 3.4%³ vs. the 6-10% recommended by many experts).

Many people are uncomfortable tackling retirement savings on their own. By one measure, 58% of households with under \$100,000 in investable assets, and 75% of households with over \$100,000 in investable assets solicit professional financial advice⁴.

¹ Social Security Administration, (<http://www.ssa.gov/policy/docs/ssb/v70n3/v70n3p111.html>): "Benefits are now expected to be payable in full on a timely basis until 2037, when the trust fund reserves are projected to become exhausted...[at that point] continuing taxes are expected to be enough to pay 76 percent of scheduled benefits."

² Oliver Wyman Retail Investor Retirement Survey 2014

³ Center for Retirement Research at Boston College, 'How Does 401(K) Auto-Enrollment Relate To The Employer Match And Total Compensation?', (http://crr.bc.edu/wp-content/uploads/2013/10/IB_13-14.pdf), October 2013

⁴ 2013 Survey of Consumer Finances

Advised individuals place the largest value on financial advisors' support for financial planning, monitoring and providing trusted advice for their holistic financial needs.

In this regard, we found that many investors prefer to seek help from financial advisors outside their workplace in part to receive holistic advice on their assets. When changing jobs, individuals often choose to roll over assets into an IRA, primarily to consolidate assets and avoid leaving assets with a former employer. Just 29% of individuals own 401(k) plans exclusively, while nearly two-thirds hold assets outside their workplace in combination with an IRA or alone in one or more IRAs.

How well are financial advisors doing their job? On average, we found that individuals with a financial advisor have more wealth than non-advised individuals across all age and income levels studied. For example, we found that advised individuals aged 35-54 years making less than \$100K per year had 51% more assets than similar non-advised investors. These are typical middle-class households in the middle of their accumulation years. Moreover, advised individuals are better investors across many key dimensions commonly associated with long term investing success. Specifically, we found that compared with individuals without a financial advisor, advised individuals

- Own more diversified investment portfolios
- Stay invested in the market by holding less cash and cash equivalents
- Take fewer premature cash distributions; and
- Re-balance their portfolios with greater frequency to stay in line with their investment objectives and risk tolerance.

The benefits financial advisors provide to their clients are now at risk. On April 14, 2015, the Department of Labor issued its Conflict of Interest rule proposal, a replacement for the Definition of the Term "Fiduciary" rule proposal withdrawn in September 2011. In our 2011⁵ study reviewing the impact of the previously proposed rule, we concluded that the Department of Labor's proposed rule change was motivated by a laudable objective: to ensure a high standard of care for retirement plan participants and account holders with regard to the receipt of services and investment guidance, amid an increasingly complex financial marketplace. However, we found the proposed rule proposal was likely to have serious negative and unintended effects on the very individuals the change was supposed to help.

Many stakeholders are now analyzing the technical details of the newly proposed rule, and there is growing concern that the proposal would again result in unintended

⁵ Oliver Wyman, 'Assessment of the Impact of the Department of Labor's Proposed "Fiduciary" Definition Rule on IRA Consumers', 2011

consequences, including limiting the ability of financial services firms and individual financial advisors to offer services to individual IRA holders and small businesses, as well as increasing investor costs due to new expenses associated with implementing the rule and transitioning many clients to a higher cost advisory model.

With regard to the impact on individuals, regrettably we reach the same overall conclusion as in the prior study. The proposed rule change is likely to have significant consequences that will adversely impact individual investors saving for retirement. For example, because the rule as proposed will take away the assistance small businesses most value, fewer new plans will be established and more plans will likely close⁶. This would directly impact the 19 MM individuals who work for small businesses with fewer than 50 employees, who do not currently have access to a workplace retirement plan and reduce the likelihood of their gaining access to a retirement plan in the future.

In the case of IRAs, if the rule is implemented as proposed⁷

- Millions of existing small balance IRA owners are likely to lose access to the financial advisor of their choice or any financial advisor at all
- The majority of others will face higher costs when providers shift brokerage accounts to advisory accounts
- Individuals without the help and support of financial advisors are less likely to open an IRA, leading to increased cash-outs when changing jobs and lower savings rates compared with advised individuals⁸
- Unadvised individuals are likely to carry excess portfolio risk due to less diversification and less frequent re-balancing.

* * *

⁶ The new rule proposal explicitly excludes small businesses with fewer than 100 employees with employee-directed plans from the prohibited transaction exemption, otherwise made available to larger plans. This will force financial advisors to limit the services they currently provide to such small businesses in connection with establishing and maintaining retirement plans.

⁷ See Oliver Wyman, 'Assessment of the Impact of the Department of Labor's Proposed "Fiduciary" Definition Rule on IRA Consumers', 2011

⁸ Prior guidance from the DOL "held that recommendations to a plan participant to take an otherwise permissible distribution, even combined with a recommendation as to how to invest distributed funds, is not fiduciary investment advice." K&L Gates, DOL Re-Proposes Rule to make Brokers, Others, ERISA Fiduciaries (Apr. 27, 2015), <http://www.klgates.com/dol-re-proposes-rule-to-make-brokers-others-erisa-fiduciaries-04-27-2015>.

Retirement is too important to get wrong. We encourage key stakeholders from the financial services industry and regulators to join together to find workable solutions that preserve individuals' access to help and support from a financial advisor of their choice as well as the business model and fee structure that best meet their needs.

Key findings

Workplace sponsored defined contribution plans are critical retirement savings vehicles

- 84% of individuals began saving for retirement via a workplace retirement plan⁹
- Workplace sponsored defined contribution plans represent the primary or only retirement vehicle for 67% of individuals who save for retirement with a tax-advantaged retirement plan¹⁰

Financial advisors help individuals that work for small businesses gain access to workplace retirement plans

- 19 million individuals who work for small businesses with fewer than 50 employees do not currently have access to a workplace sponsored retirement plan
- Small businesses that work with a financial advisor are 50% more likely to set up a retirement plan (and micro business with 1-9 employees are almost twice as likely)

The majority of retail investors seek financial advice – many want personalized services from a professional financial advisor outside their workplace for financial planning and holistic advice and support on all their investment holdings

- 58% of households with under \$100,000 in investable assets, and 75% of those with over \$100,000 in investable assets solicit professional financial advice
- Individuals most value financial advisors for support with financial planning, monitoring and trusted advice for their holistic financial needs
- Many individuals currently have access to help and advice on their plan assets through workplace retirement plans; those that use it save 43% more on average. However, fewer than half of workplace retirement plan participants currently use in-plan advice features

⁹ Oliver Wyman Retail Investor Retirement Survey 2014

¹⁰ Oliver Wyman Retail Investor Retirement Survey 2014

- Two-thirds of investors have retirement savings outside of employer-sponsored retirement plans, and many seek advice and support from a professional advisor outside their workplace for all of their investment holdings

Advised investors have more assets than those without a financial advisor

- We found that advised individuals have a minimum of 25% more assets than non-advised individuals
- In the case of individuals aged 35-54 years with \$100,000 or less in annual income, advised individuals have an average of 51% more assets than non-advised individuals

Individuals with a financial advisor are better long term investors

- Advised investors have more diversified portfolios -- own twice as many asset classes, have more balanced portfolio asset allocations and use more packaged products for equity exposure compared with non-advised investors
- Advised investors stay more invested in the market – Advised individuals hold less cash in their investment accounts (36%-57% less than non-advised individuals for similar age and wealth cohorts)
- Advised investors re-balance more frequently, and are 42% more likely to re-balance their portfolios at least every two years

The Department of Labor's proposed Conflict of Interest rule would likely reduce retirement savings

- As proposed, financial advisors would be forced to stop providing workplace retirement plan set-up and support services to small businesses, due to the lack of an exception that would allow providers to market to self-directed plans with fewer than 100 participants, which will likely result in many small businesses closing existing plans or not establishing new plans due to the additional administrative burden
- Individuals with small balance accounts that are below standard advisory account minimums are likely to lose access to retirement help and support with selecting appropriate products as a result of providers shifting accounts from brokerage to fee-based advisory accounts. In our prior study, we estimated that 7 MM current IRAs would not qualify for an advisory account due to low balances¹¹

¹¹ Oliver Wyman, 'Assessment of the Impact of the Department of Labor's Proposed "Fiduciary" Definition Rule on IRA Consumers', 2011

- Almost all retail investors face increased costs (73% to 196% on average) from providers shifting clients to a fee-based advisory model. In our 2011 study, we found nearly 90% of the 23 MM IRAs analyzed were held in brokerage accounts¹²
- When changing jobs, individuals will be less likely to open an IRA to manage their plan savings, leading to lower savings rates and increased cash-outs¹³. In our 2011 study, we found that as many as 360,000 fewer IRAs would be opened every year
- Unadvised individuals will likely carry excess portfolio risk due to less diversification and less frequent re-balancing compared with advised individuals

¹² Oliver Wyman, 'Assessment of the Impact of the Department of Labor's Proposed "Fiduciary" Definition Rule on IRA Consumers', 2011

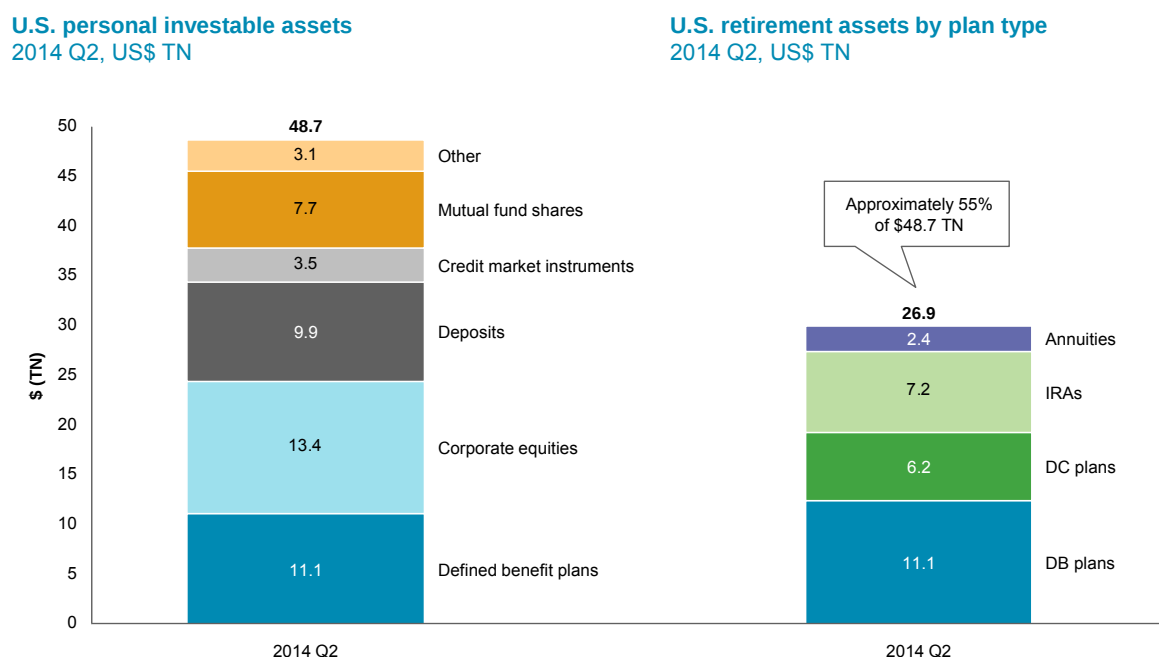
¹³ Prior guidance from the DOL "held that recommendations to a plan participant to take an otherwise permissible distribution, even combined with a recommendation as to how to invest distributed funds, is not fiduciary investment advice." K&L Gates, DOL Re-Proposes Rule to make Brokers, Others, ERISA Fiduciaries (Apr. 27, 2015), <http://www.klgates.com/dol-re-proposes-rule-to-make-brokers-others-erisa-fiduciaries-04-27-2015>.

I. Role of financial advisors in the defined contribution plan market

Two-thirds of retirement assets are held in workplace retirement plans

At an estimated \$26.9 TN, US retirement savings represent over half of total personal investable assets. Of this amount, workplace sponsored retirement plans such as defined benefit (DB) and defined contribution (DC) plans constitute approximately two-thirds of retirement assets, while the remaining one-third is held in IRAs and annuities (Figure 1).

Figure 1: US personal investable assets and retirement assets¹⁴



Individuals are increasingly responsible for saving for their own retirement

Nearly five times as many individuals are active participants in DC plans as compared to DB plans as of 2012 (75.4 million vs. 15.7 million).^{15,16} Moreover, as Figure 2 shows,

¹⁴ Federal Flow of Funds L.116, B.100: Includes financial assets and defined benefit assets; excludes agency and GSE backed securities, other loans and advances, mortgages, consumer credit (student loans), pension entitlements and equity in non-corporate business

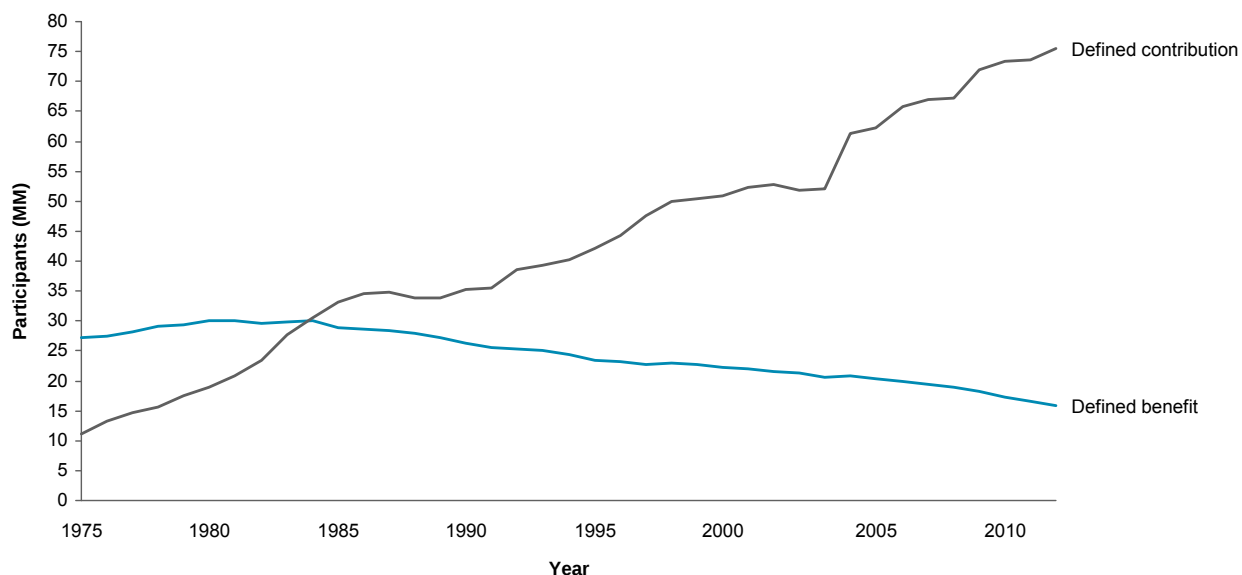
Federal Flow of Funds L.116: Retirement assets include household retirement assets

¹⁵ Private Pension Plan Bulletin Historical Tables and Graphs, U.S. Department of Labor, Employee Benefits Security Administration, December 2014

¹⁶ Note: Aggregation methodologies were changed in 2004 and 2009, generating anomalies for those years

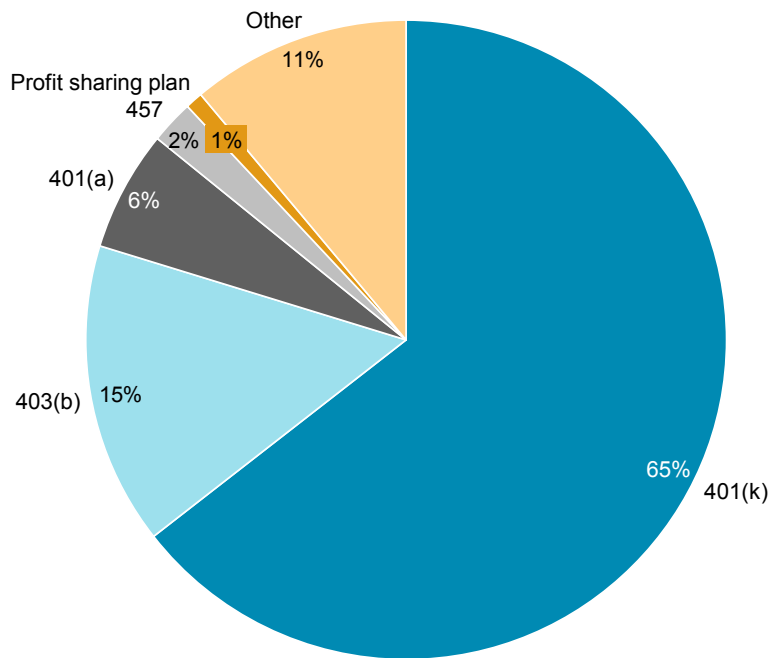
the long-term trend continues to favor DC plans. As a result, the level of retirement assets available to individuals is now dependent upon a number of factors both within and outside their control, including employment status, personal contribution rate, the availability of employer matching contributions, investments selected and market performance.

Figure 2: Active retirement plan participants (see footnotes 8,9)



Within the broad category of defined contribution plans, there are a number of different vehicles such as 401(k), 403(b), 401(a), 457 and profit sharing plans with different features to suit the needs of a wide range of business plan sponsors and individuals. As illustrated in Figure 3, the most popular vehicle by share of assets is the 401(k).

Figure 3: Defined contribution assets by plan type (2013 YE)¹⁷



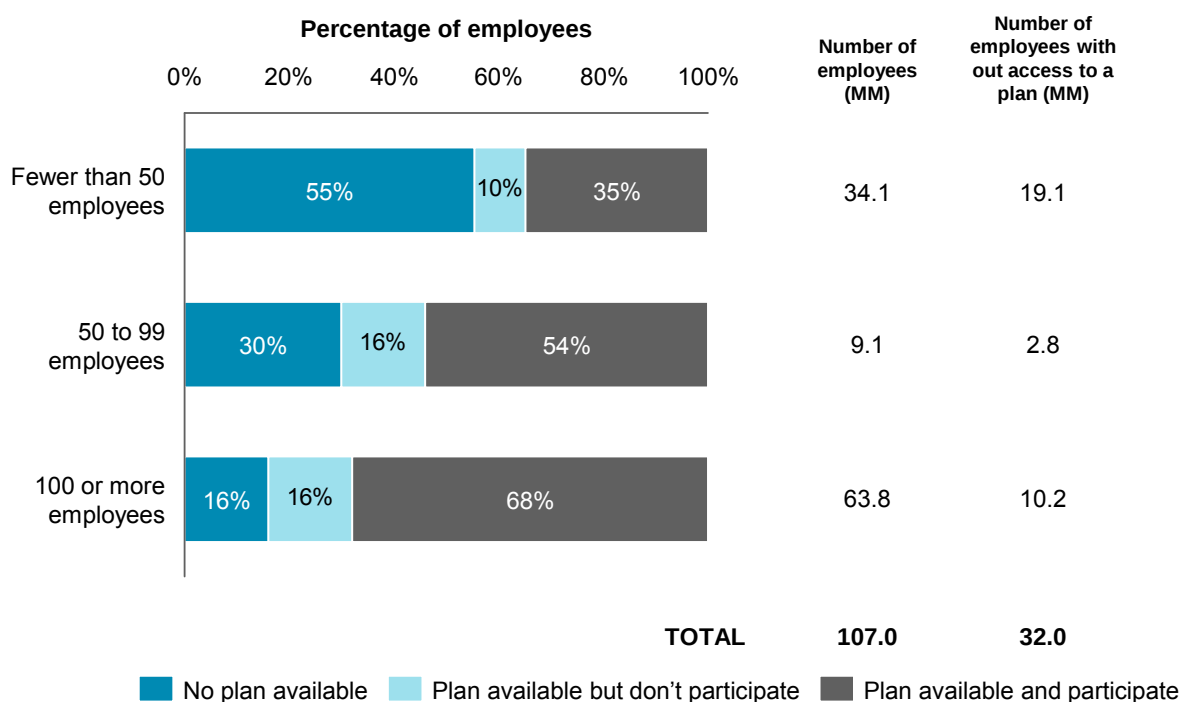
Based on our retail investor survey, we found that workplace retirement plans are vital for individuals to start saving for retirement – 84% of respondents began saving for retirement via a workplace retirement plan.

More than 80% of retail investors surveyed began saving for retirement through workplace retirement plans

¹⁷ Pensions & Investments Research Center: (<http://researchcenter.pionline.com/rankings/dc-money-manager/plantype/2014?limit=213>)

As of 2013, approximately 75 million, or 70% of the 107.0 million full-time and part-time US private sector workers, had access to a workplace retirement plan, and 60 million, or 56% of 107.0 million, chose to participate. Of the 32 million private sector workers without access, nearly two-thirds, or 19 million, are employed by small businesses with fewer than 50 employees (Figure 4).¹⁸

Figure 4: Workplace retirement plan access and participation among private sector workers, W-2 adjusted rates, by firm size (2013)



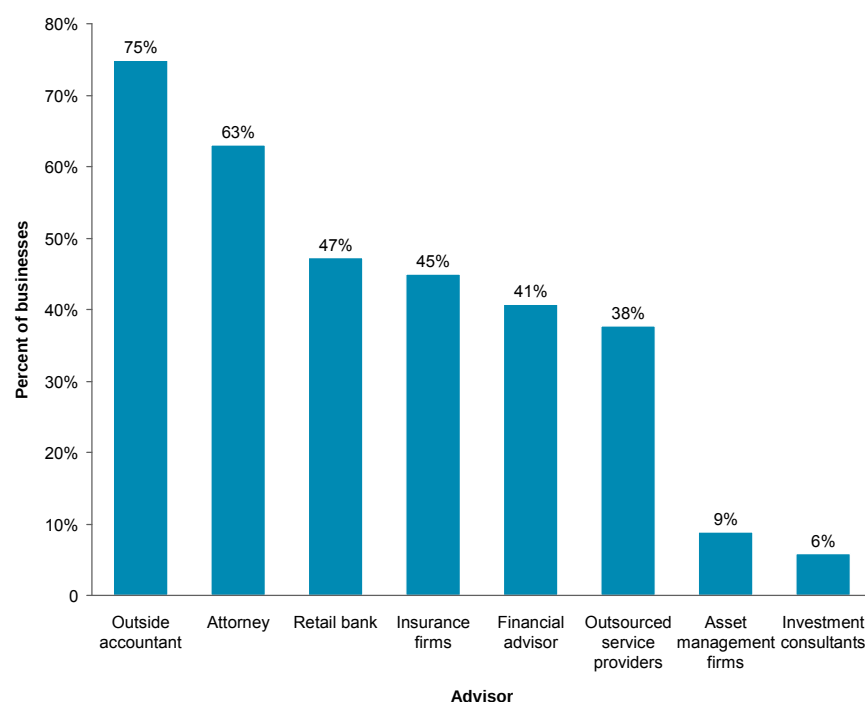
¹⁸The number of employees by firm size is based on Investment Company Institute tabulations of the US Census' Current Population survey (www.ici.org/info/per20-06_data.xls). We use W-2 adjusted self-reported access and participation rates, as compiled by Dushi, Iams, and Lichtenstein ('Assessment of Retirement Plan Coverage by Firm Size Using W-2 Tax Records', Social Security Administration, 2011, <http://www.ssa.gov/policy/docs/ssb/v71n2/v71n2p53.pdf>). This study accounts for under- and over-reporting of plan participation by using individual tax filings to identify tax-deferred contributions, and avoids the issues of double-counting of individuals active in more than one plan and non-active participants in plans with short-form filings associated with available DOL data.

Our research provides interesting insights into reasons for the lower availability rates of workplace retirement plans among small businesses. When asked to select their reasons for not offering a plan, we found that cost (47% of small business survey respondents), prioritization of other employee benefits (24%) and significant use of temporary labor (20%) were the most commonly cited barriers to DC plan formation.

Barriers to small business plan formation include cost, prioritization of other benefits and temporary labor

In contrast to large businesses that often employ investment consultants to assist internal governance committees with managing a DC plan, small businesses typically rely on a circle of trusted advisors. We found small businesses most commonly seek advice from a range of providers including accountants, attorneys, retail banks, insurance firms, financial advisors, and outsourced service providers. Figure 5 shows the prevalence of these advisors among small businesses.

Figure 5: Prevalence of different advisor types among small businesses¹⁹



¹⁹ Oliver Wyman Small Business Retirement Survey 2014, Respondents were asked to select all of the advisors that they consult in the management of their business, hence the sum is greater than 100%. Participants were asked to select from the following options: outside accountant (CPA), outsourced service, financial advisor (e.g. Merrill Lynch, Morgan Stanley, Independent financial professional), asset management firms (e.g. Vanguard, T. Rowe Price), attorney, retail bank (other than private banks and brokerages within banks, e.g. JPMorgan Chase, Bank of America, HSBC, Citibank), investment consultants (e.g. Aon Hewitt, Mercer), insurance firms (e.g. Aetna, Nationwide), and none (I am solely responsible for all business decisions).

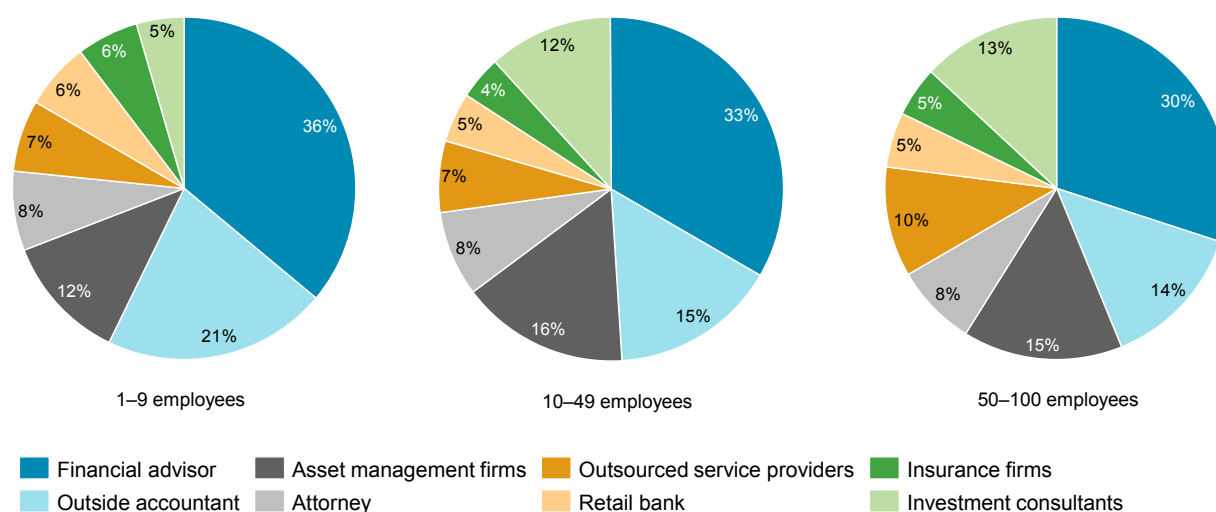
Financial advisors help small businesses set up workplace retirement plans

Small businesses use advisors for a range of services for their DC plans, which vary from plan to plan and from advisor to advisor. Examples of typical services include:

- Development of an investment policy statement covering aspects such as plan objectives, investment philosophy and risk appetite
- Plan design consulting (e.g. choice of funds, use of auto-enrollment, QDIA, auto-escalation, and employer matching program), and selection of a record-keeper
- Participant education and support (e.g. general help and support around plan participation, contribution rates and investment options, investment planning and IRA rollovers).

Small businesses perceive financial advisors to be most helpful with respect to guidance on retirement plan setup and administration. We asked survey respondents to allocate 100 points among their different advisors based upon the value they assigned to their help and support in choosing to set up a workplace retirement plan. As shown in Figure 6, this statement holds true across all types of advisors and business sizes with small businesses allocating between 30% and 36% of value to financial advisors.

Figure 6: Value of advice attributed to advisors in choosing to set up a retirement plan²⁰

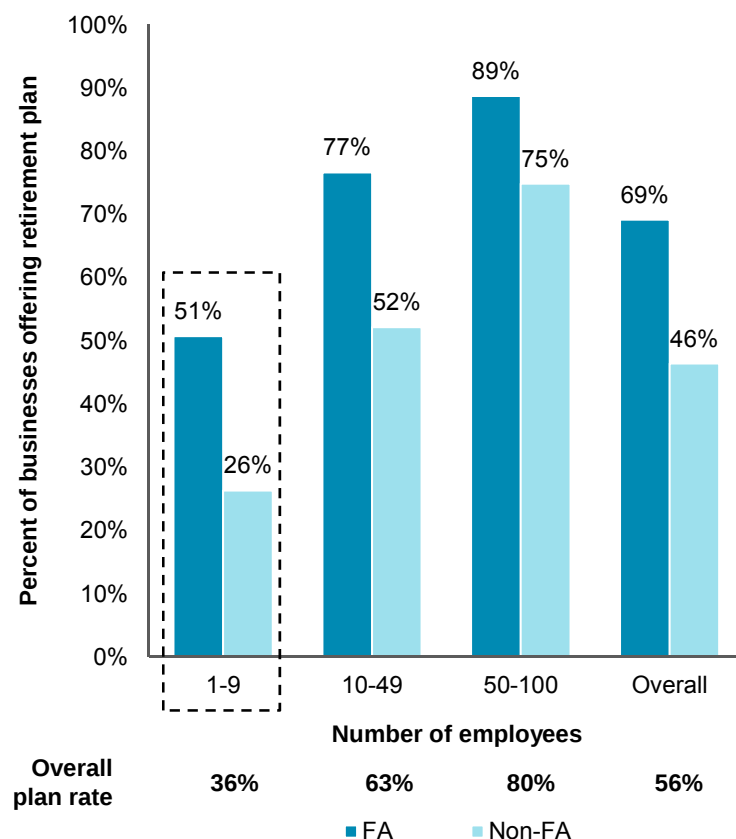


²⁰ Oliver Wyman Small Business Retirement Survey 2014, Respondents were asked to allocate 100 points across all their advisors in terms of their contribution to the business setting up a workplace retirement plan; presented values are calculated as the average score per advisor type.

Small businesses with financial advisors are 50% more likely to set up a retirement plan overall and micro businesses with financial advisors are nearly twice as likely to set up a plan

We found that 41% of small businesses with 100 or fewer employees work with a financial advisor, and that these firms are significantly more likely to set up a retirement plan. Specifically, businesses with 1–9 employees with a financial advisor are almost twice as likely to set up a retirement plan as are businesses without financial advisors (51% vs. 26%). Businesses with 10–49 employees with a financial advisor are 48% more likely (77% vs. 52%) and businesses between 50 and 100 employees are 19% more likely (89% vs. 75%) to set up a plan. These differences are illustrated in Figure 7 below. Additionally, micro businesses (1-9 employees) with financial advisors are 18% more likely to offer employer matching with a financial advisor (85%) than without (72%).

Figure 7: Plan formation rates by size of firm and advisor status²¹

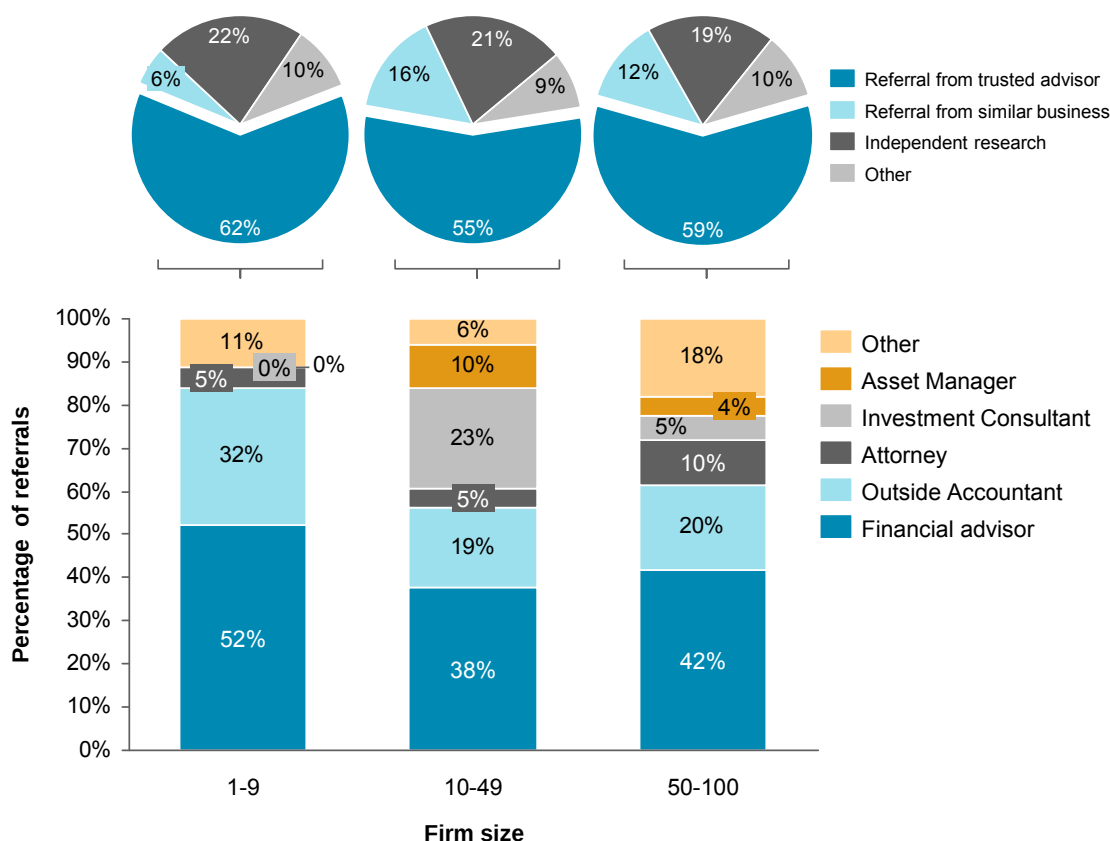


²¹ Oliver Wyman Small Business Retirement Survey 2014

Financial advisors play a key role in referring small businesses to service providers, such as plan administrators/ recordkeepers and fiduciary service providers

As Figure 8 shows, a majority of small businesses, ranging from 55%–62% depending on size, found their workplace retirement plan provider via a referral from a trusted advisor. Financial advisors and accountants were the most common referral sources on a relative basis, with financial advisors cited between 33–45% of the time²², depending on company size.

Figure 8: Frequency of referral to service provider(s), by advisor²³



²² Raw results are normalized to account for relative frequencies of different advisors. For example, in the 1-9 business segment, financial advisors provide 41% of all referrals on an unadjusted basis. We weighted this figure by the prevalence of financial advisor relationships among these businesses (i.e. 38%) and re-scaled all advisor scores to total 100%. This approach yields relative referral rates by removing skews associated with advisor prevalence.

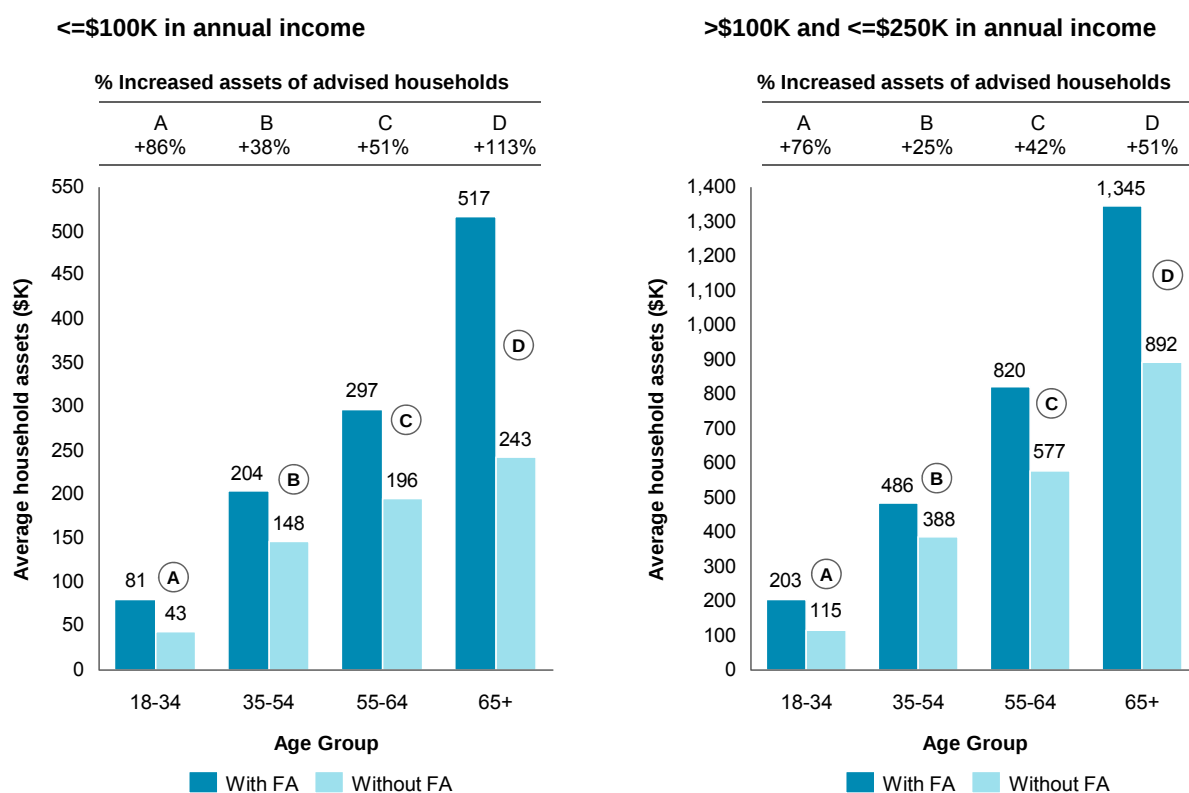
²³ Oliver Wyman Small Business Retirement Survey 2014

II. Role of financial advisors in helping individuals save for retirement

In our Retail Investor Retirement Survey, advised investors had a minimum of 25% more assets than non-advised individuals, depending on age and income levels

A key finding of our research is that individuals with a financial advisor have more assets than non-advised individuals across age, income, and wealth segments, as shown in Figure 9.

Figure 9: Total asset levels across relationship status, age, and income²⁴



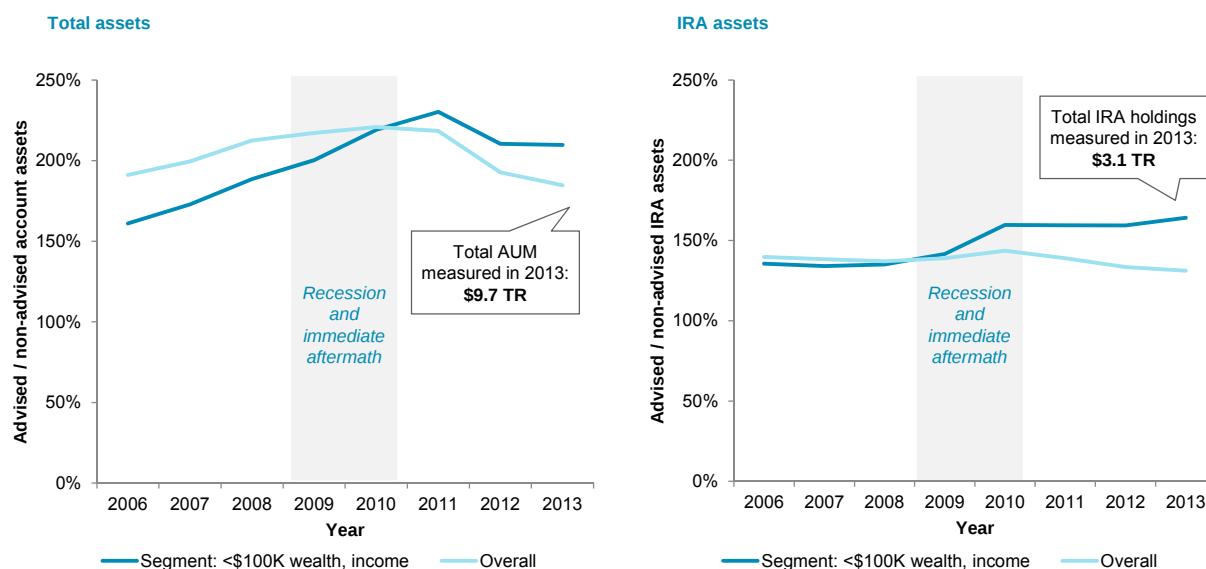
This finding holds true even when excluding survey respondents who anticipate receiving retirement income from either an inheritance or trust fund.

²⁴ Oliver Wyman Retail Investor Retirement Survey 2014

Our analysis of the IXI data, representing ~20% of U.S consumer invested assets, further substantiates and expands on this finding. We found that individuals with a financial advisor have larger account balances (including IRA assets) across age, income and wealth levels. Specifically, in 2013, 98% of accounts examined for advised individuals reflected $\geq 10\%$ more investment assets compared to those of non-advised individuals controlling for age, wealth, and income. Moreover, 90% of accounts reflected $\geq 25\%$ more investment assets among advised accounts.

This finding holds true across multiple time periods for specific wealth and income cohorts. Figure 10 illustrates this point for all segments as well as the segment with annual income and wealth below \$100,000.

Figure 10: Ratio of average asset holdings for advised and non-advised investors²⁵



As described in detail below, our research finds that individuals with a financial advisor are better investors across many dimensions commonly associated with long term investing success.

Advised individuals are better long term investors

Key elements of a robust long-term investing program typically include:

- A. Developing and maintaining a personalized financial plan

²⁵ IXI account-level time series dataset of U.S. Consumer Invested Assets; Oliver Wyman Analysis

- B. Commitment to regular saving and investment
- C. Constructing and maintaining a well-diversified portfolio of appropriate investment products
- D. Staying invested in the market
- E. Periodically re-balancing investment holdings to restore desired asset allocation and risk levels

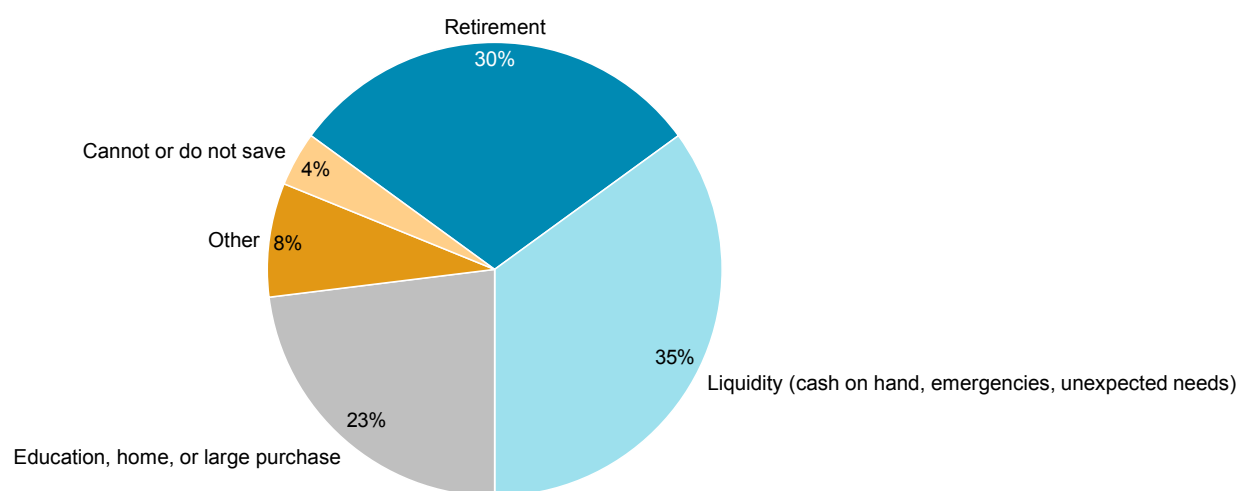
We found that financial advisors play an important role in helping individuals adopt each of these investing practices commonly associated with better investing outcomes.

A. Developing and maintaining a personalized financial plan

Individual investors' savings goals include liquidity, education and retirement, but their primary focus varies with life stage

Individuals have a range of different investment goals. As indicated in Figure 11, investors' most common investing objectives are ensuring sufficient liquidity; saving for retirement; and funding education or a large purchase, such as a home.

Figure 11: Households' primary reasons for saving²⁶



The primary reasons for saving often vary significantly with life stage, however. In a recent survey, the Investment Company Institute (ICI) found that Households with a head of household younger than 35 primarily save for liquidity purposes (39%), whereas

²⁶ Investment Company Institute, The Success of the U.S. Retirement System, Figure 1 (http://www.ici.org/pdf/ppr_12_success_retirement.pdf)

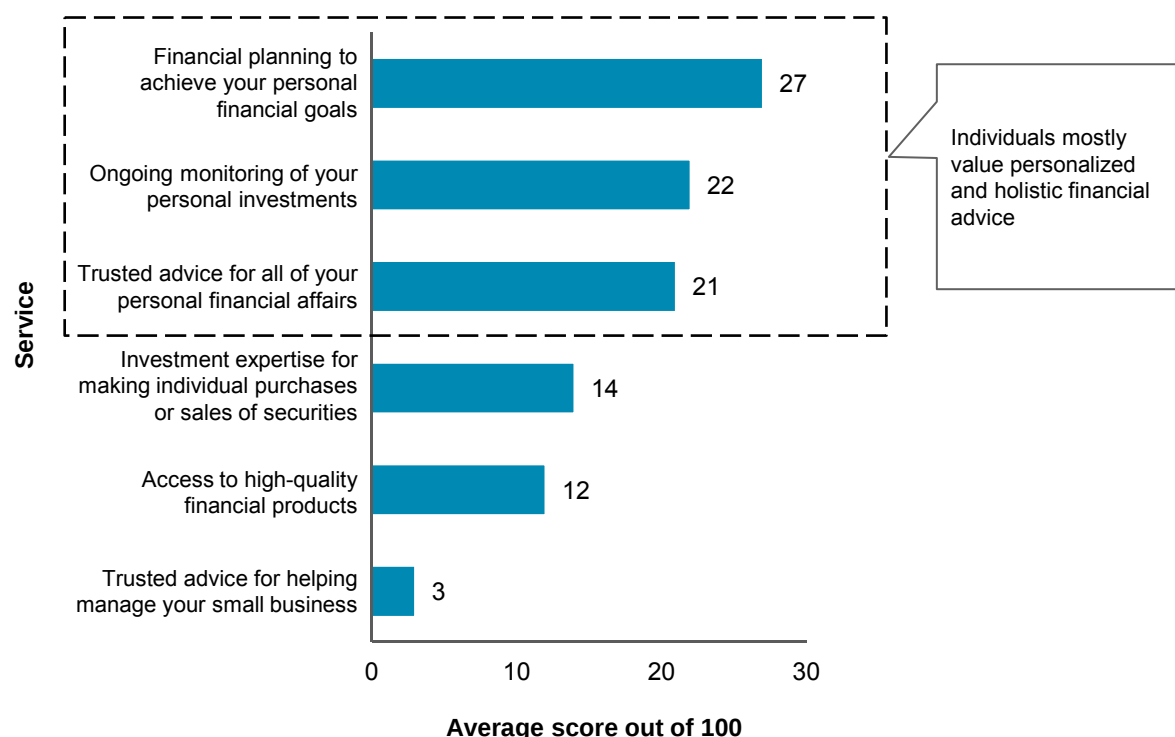
those in which the head of household is between 50 and 64 years old, are focused on retirement savings (48%).

58-75% of non-retired households seek professional financial advice, depending on wealth, and most value personalized financial planning, investment monitoring and holistic advice

Many Americans are uncomfortable with investing on their own, and consult with a financial advisor to assist with achieving their goals. By one measure, 58% of households with under \$100,000 in investable assets, and 75% of non-retired households with over \$100,000 in investable assets, solicit professional financial advice²⁷.

In our research, individuals most value the following services from their financial advisor: personalized financial planning, ongoing monitoring of investments and trusted advice for all their personal financial affairs (Figure 12).

Figure 12: Financial advisor services valued by investors²⁸



²⁷ 2013 Survey of Consumer Finances

²⁸ Oliver Wyman Retail Investor Retirement Survey 2014

Against investor demand for holistic advice, we observe different help and support models available within workplace retirement plans and outside plans. In-plan help and advice is often well suited for individuals whose workplace plan represents their primary investment savings, while outside plan advice is a better fit for individuals with multiple investment accounts seeking advice and guidance on all investment holdings.

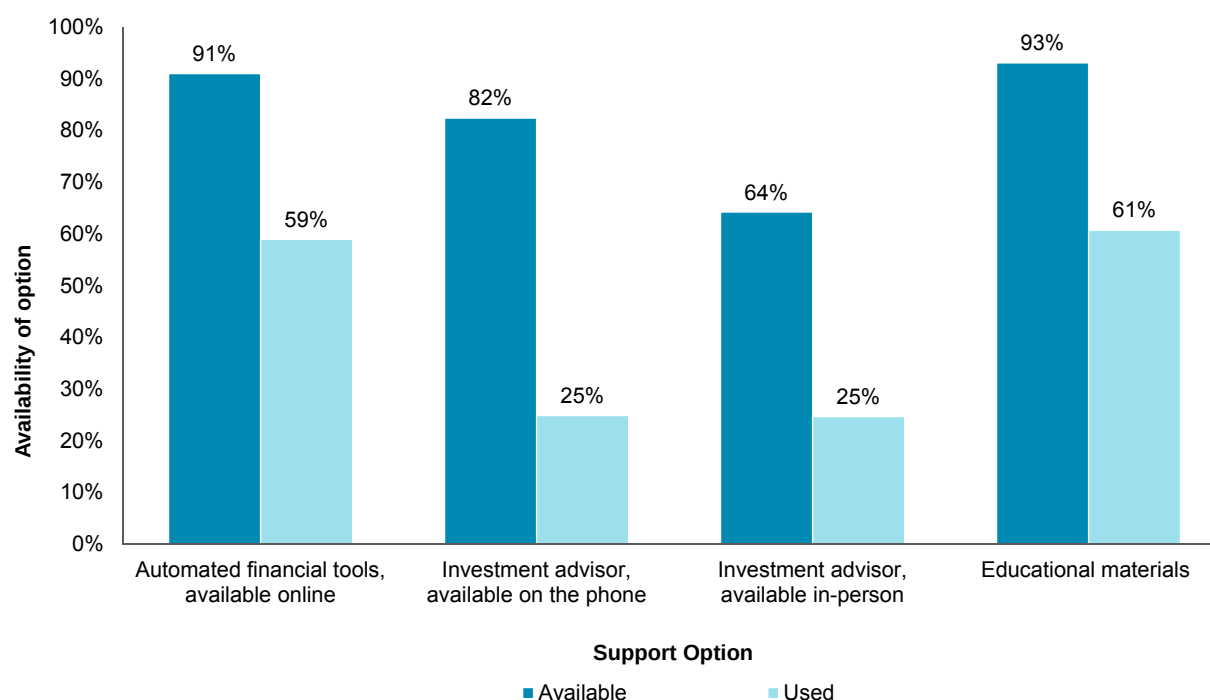
The majority of DC plans now offer a variety of educational materials, tools and advice options to enable individuals to make informed investment decisions. Educational materials and automated financial tools are the most widely available as well as the most used features as shown in Figure 13. In our research, in-plan advice had a positive impact on participant behavior for those who used it. We found participants who made use of at least one type of support contributed an average of 2.0 percentage points²⁹ more of their salary to a DC plan (6.7% vs. 4.7%) – an increase of 43%. When done in younger working years, this difference could mean a substantial difference in asset accumulation at retirement.

Participants who use in-plan advice features save 43% more, on average

We also found that fewer than half of plan participants currently use in-plan advice features. While 82% of individuals have access to an investment advisor on the phone and 64% have the ability to meet with a financial advisor in-person, utilization of these services is low. Of the individuals that participated in our survey, just 25% consulted with an advisor on the phone and 25% met with a financial advisor in-person.

²⁹ Oliver Wyman Retail Investor Retirement Survey 2014

Figure 13: Availability and usage of in-plan support options (for respondents with a defined contribution plan)



In-plan advice models are often more limited in scope compared with external advisory offerings

A number of financial firms operating in a brokerage model have forged partnerships with in-plan advice providers such as Financial Engines, Morningstar and Wilshire Associates, instead of establishing a relationship with their financial advisory businesses, to provide basic help and advice to plan participants on current plan holdings and investment options.^{30,31,32} Due to legal constraints, this form of advice is generally limited to plan assets, which does not meet the full needs of individuals that hold assets in multiple DC plans and other brokerage and/or advisory accounts.

³⁰ Financial Engines, 2012 Annual Report (<http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MTc3OTk4fENoaWxkSUQ9LTF8VHlwZT0z&t=1>)

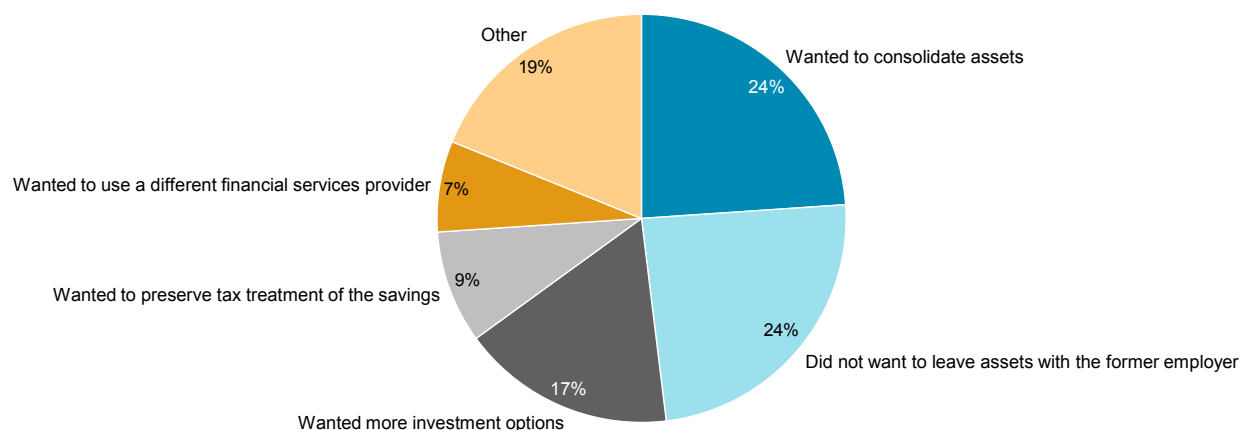
³¹ Morningstar, 2012 Annual Report, (<http://corporate.morningstar.com/us/documents/PR/2012-Morningstar-Annual-Report.pdf>)

³² Wilshire Associates, Retirement Managed Accounts, (<http://www.wilshire.com/funds-management/our-solutions/retirement-managed-accounts>)

Individuals elect IRA rollovers for many reasons including asset consolidation, increased investment options and access to a different financial services provider

Many individuals prefer to access financial help and support outside of their DC plans and choose to rollover their DC plan assets to an IRA when changing employers. According to a 2014 ICI report, “The Role of IRAs in US Household Saving for Retirement”, more than 41 million US households hold an IRA of some type. In addition, as shown in Figure 14, ICI further found that nearly half of all rollover decisions were motivated by a desire to consolidate assets and avoid leaving assets with the former employer.

Figure 14: Primary reason for most recent rollover among those choosing to roll over assets³³



Only 29% of workplace plan participants use DC plans exclusively for retirement savings; nearly two-thirds use a combination of DC plans and IRAs or IRAs only³⁴

As demonstrated by the distribution of retirement plans within our sample of investors (Figure 15), 44% of individuals utilize both DC plans and IRAs in order to take advantage of the benefits of each type of account. As noted previously, IRAs offer

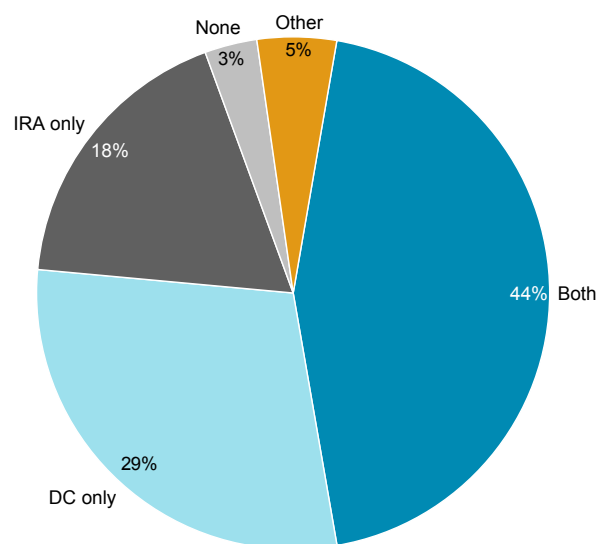
³³ Investment Company Institute, The Role of IRAs in U.S. Households' Saving for Retirement, 2014 (<http://www.ici.org/pdf/per21-01.pdf>)

Other includes 'Were told by a financial advisor to roll over assets', 'Wanted to keep assets with the same provider', 'Thought it was easier to roll over assets to an IRA', and 'Wanted the same investments as former employer's plan'.

³⁴ Oliver Wyman Retail Investor Retirement Survey 2014

access to holistic help and support, a wider selection of financial products, and greater control. In comparison, DC plans have a higher limit for tax-deferred annual savings (e.g. \$18,000 for 401(k)s vs. \$5,500 for IRAs, excluding catch up contributions) and employer matching contributions (where available), making them attractive vehicles for new retirement contributions.

Figure 15: Retirement plan ownership among investors³⁵



B. Commitment to regular saving and investment

Individuals with a financial advisor are more likely to own an IRA, have greater IRA assets and save more of their income in 401(k) plans

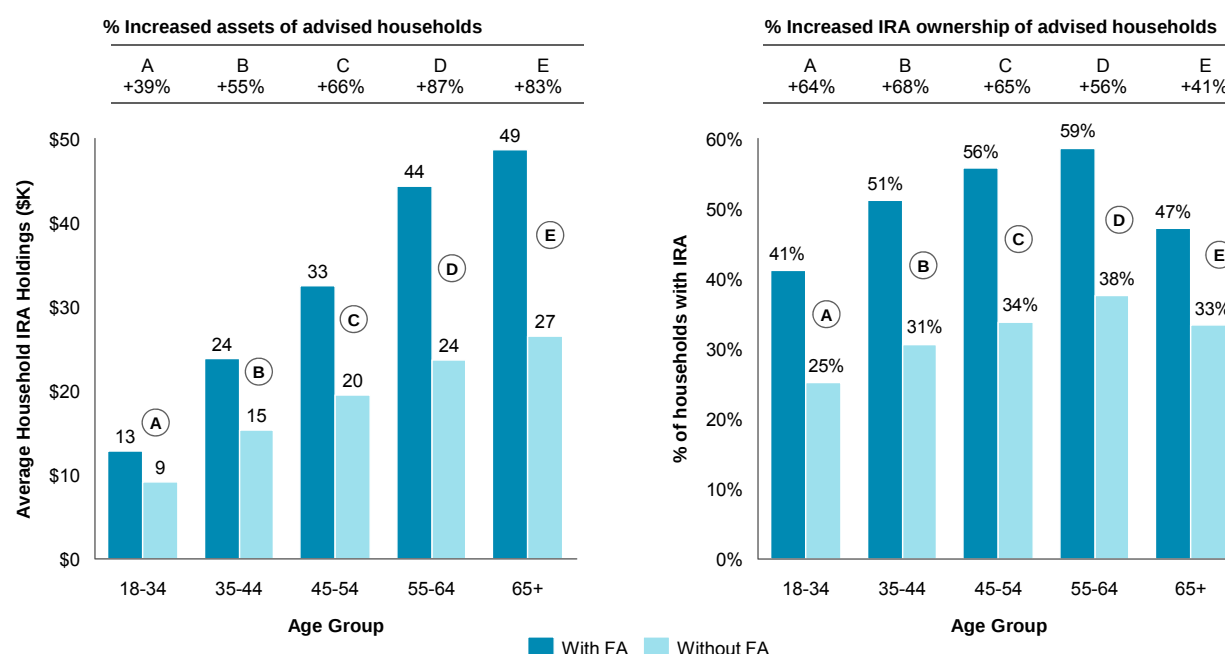
Individuals with a financial advisor are more likely to have an IRA. In 2013, 99.8% of households examined belonged to an age / income / wealth segment in which advised households were $\geq 10\%$ more likely to have an IRA compared to non-advised households (and 87% of households belonged to segments in which advised households were $\geq 25\%$ more likely to have an IRA).

Additionally, 94% of households examined belonged to an age / income / wealth segment in which advised households held $\geq 25\%$ more IRA assets compared to non-advised households. Our findings for IRA ownership and asset levels hold true across income, age, and wealth segments. For example, Figure 16 shows IRA ownership and

³⁵ Oliver Wyman Retail Investor Retirement Survey 2014, includes only those with retirement or investment accounts

assets for advised and non-advised households within different age groups for the cohort with \$0-100K in annual income and wealth, respectively. In this cohort, increased IRA ownership ranges from 41% higher for households with accounts registered to individuals 65 and older to 68% higher for those in the 35-44 age group. IRA asset levels for the \$0-100K annual income and wealth cohort ranges from 39% higher for households with accounts registered to individuals aged 18-34 to 87% more for those aged 55-64.

Figure 16: IRA ownership and assets (2013) – Income: \$0-100K, Wealth: \$0-100K ³⁶



These results are consistent with a recent Natixis survey, where individuals with a financial advisor were found to hold more assets in their 401(k) across age and income segments, compared with non-advised investors. The Natixis survey also found that individuals with a financial advisor contributed an average of 1-2% more of their pre-tax salary to their 401(k) across age and income segments. ³⁷

³⁶ IXI household-level dataset of U.S. Consumer Invested Assets; Oliver Wyman Analysis

³⁷ Saving is Not Enough: Liabilities, shortfalls and the need for active participation in 401(k) plans; Natixis Global Asset Management, August 2014 – online survey of 899 participants (427 with FA, 472 without FA) across age and groups

C. Constructing and maintaining a well-diversified portfolio of appropriate investment products

The benefits of portfolio diversification are well documented. Figure 17 shows how a diversified balanced index outperformed the S&P 500 by an average of 1.7 percentage points annually (11.2% vs. 9.5%) over a long time period (1965-2012) spanning multiple business cycles.

Figure 17: Comparison of return by portfolio composition³⁸

Portfolio Mix	1965-1981	1982-1999	2000-9/2012	Total Period
S&P 500 Index	+6.3%	+18.5%	+1.7%	+9.5%
Cash	+6.7%	+6.2%	+2.2%	+5.3%
Diversified Balanced Index	+9.9%	+15.1%	+7.4%	+11.2%

Individuals with a financial advisor exhibit more diversified investment portfolios compared to non-advised individuals across a number of dimensions

Portfolio diversification refers to the practice of mitigating investment risk by investing in a variety of un-correlated products. There are a number of ways to assess portfolio diversification. We have attempted to assess relative portfolio diversification between advised and non-advised individuals with respect to several basic measures.

1. **The number of asset classes within the portfolio** – The correlation between investments in different asset classes is typically lower than that between investments in the same asset class. Thus, the more distinct asset classes in an investor's portfolio the more diversified the portfolio, on average.
2. **The ratio of equities to fixed income** – This is a basic measure of portfolio risk with a higher concentration in equities typically signaling a riskier portfolio. A "60/40" portfolio consisting of 60% equity and 40% fixed income is widely recognized as a balanced portfolio that provides capital appreciation and income while limiting volatility and potential loss of capital. A substantial overweighting of

³⁸ DFA Returns 2.0

equities or fixed income could indicate a misalignment between intended and actual risk-taking.

- 3. The use of packaged products vs. individual securities** – Packaged products like mutual funds are typically composed of many securities, and have lower non-systematic risk (i.e. individual company risk exposure) than an equivalent investment in a smaller number of individual securities. As a result, investment strategies employing packaged products tend to be more diversified than strategies that rely only on individual securities.

Based on each of these three measures of diversification, we found individuals with a financial advisor have more diversified portfolios than individuals without a financial advisor.

1. Number of asset classes within the portfolio – Individuals with a financial advisor own twice as many asset classes as non-advised individuals

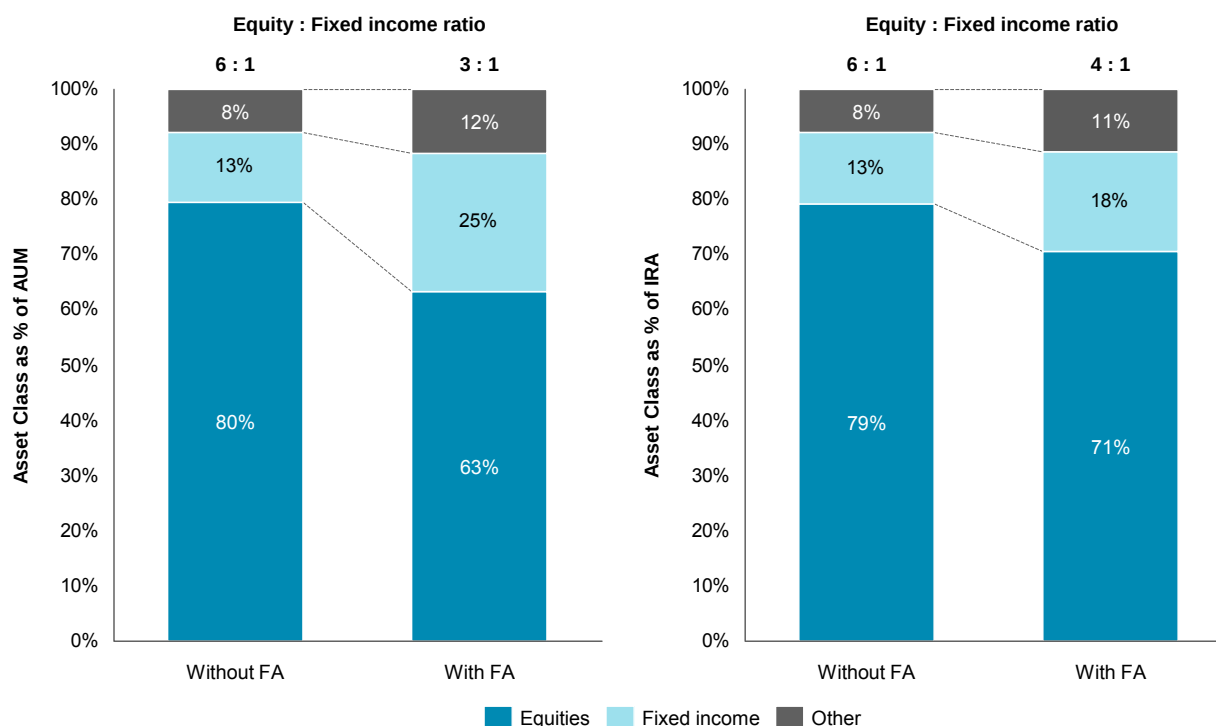
In a 2010 study, Charles Schwab found that financial advisors help clients achieve greater investment diversification, and that the average investor receiving professional advice invests in over four more asset classes than an investor who does not (e.g. more than 8 versus 3.7)³⁹.

2. Ratio of equities to fixed income -- Advised individuals have more balanced portfolios than non-advised investors, and hold, on average, more than 20% less equities and nearly twice as much fixed income

Individuals with a financial advisor have more balanced portfolios with less equity exposure and higher fixed income allocations than non-advised individuals. As shown in Figure 18, advised individuals held 17 percentage points (more than 20%) less equity than non-advised individuals, as well as nearly twice as much fixed income exposure (25% vs. 13% as a percent of the total portfolio). IRA holdings show a similar finding where the difference in equity exposure is 8 percentage points (or 10%) less of an allocation for advised individuals vs. those without a financial advisor. By contrast, fixed income exposure is 38% higher for advised vs. non-advised individuals.

³⁹ Charles Schwab, 'Advice Matters: New Charles Schwab Study Demonstrates Positive Impact of Professional Advice on 401(k) Investor Behavior', (<http://pressroom.aboutschwab.com/press-release/schwab-corporate-retirement-services-news/advice-matters-new-charles-schwab-study-demo>)

Figure 18: Assets and IRA asset class mix for households with and without a financial advisor⁴⁰

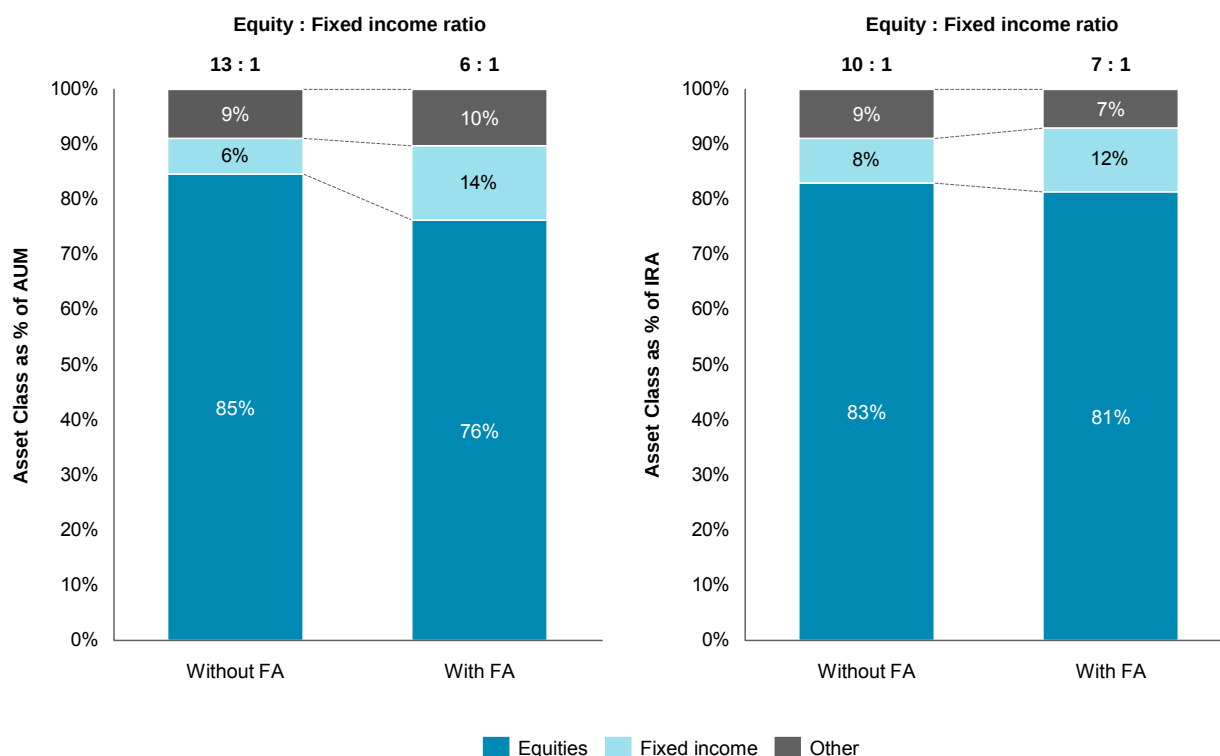


The finding of more balanced portfolios among advised individuals persists when controlling for age, income, and wealth, as 72% of households belong to a segment in which advised households hold more than 20% less of their assets in equities⁴¹. By way of further example, Figure 19 shows the same analysis of the segment aged 45-54 with less than \$100,000 in annual income and total wealth, respectively. In this case, the difference in equity exposure is 76% vs. 85% of total assets for advised vs. non-advised individuals. Additionally, advised individuals hold more than twice as much fixed income as a percent of total assets, and 1.5 times as much in IRAs.

⁴⁰ IXI household-level dataset of U.S. Consumer Invested Assets; Oliver Wyman Analysis; percentages may not add up to 100% due to rounding

⁴¹ Measured as a percentage of the total portfolio assets

Figure 19: Assets and IRA asset class mix – Age: 45-54, Income: \$0-100K, Wealth: \$0-100K⁴²

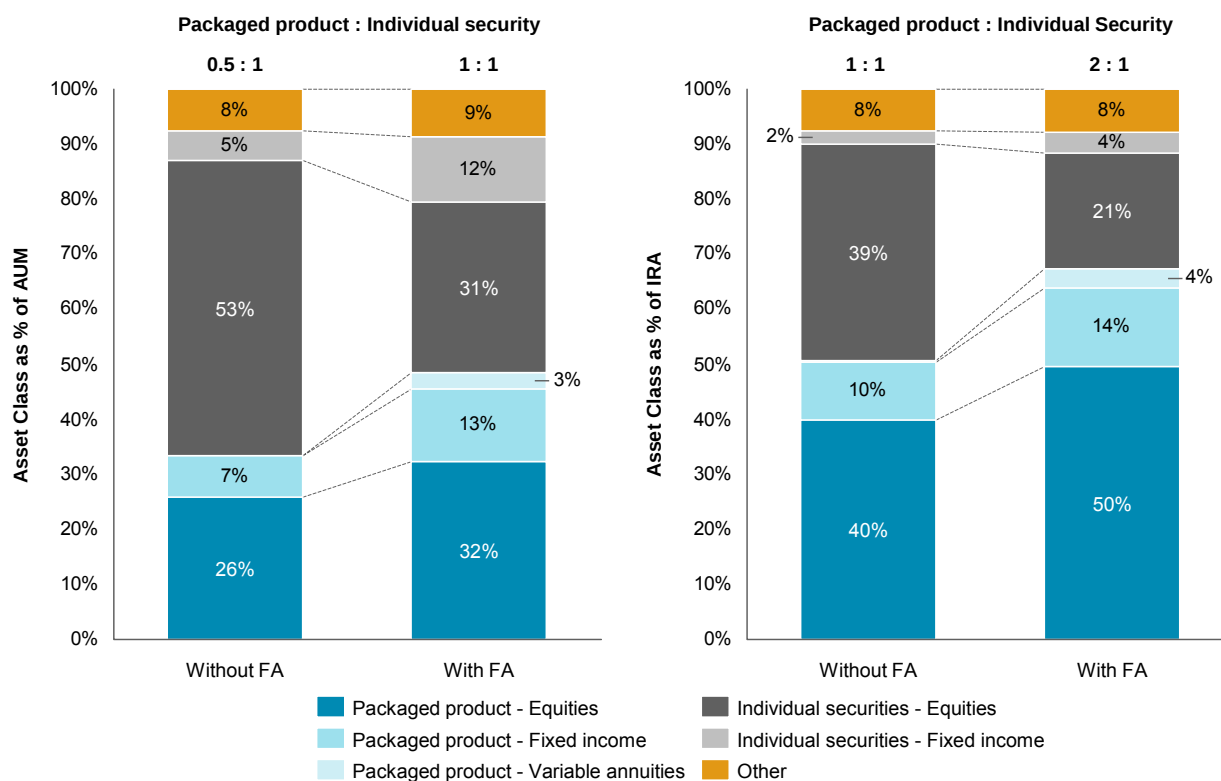


3. Use of packaged products vs. individual securities – Non-advised individuals hold 70% more of their equities exposure in individual securities compared to advised individuals

Finally, individuals with a financial advisor hold more of their equity exposure in packaged products compared to individuals without a financial advisor. Figure 20 shows individuals with a financial advisor hold approximately equal proportions of their equity exposure in packaged products and individual securities. By contrast, investors without a financial advisor hold 1.7 times as much of their equity exposure in individual securities, on average. The mix of IRA holdings again reflects this trend.

⁴² IXI household-level dataset of U.S. Consumer Invested Assets; Oliver Wyman Analysis

Figure 20: Assets and IRA product mix for households with and without a financial advisor⁴³

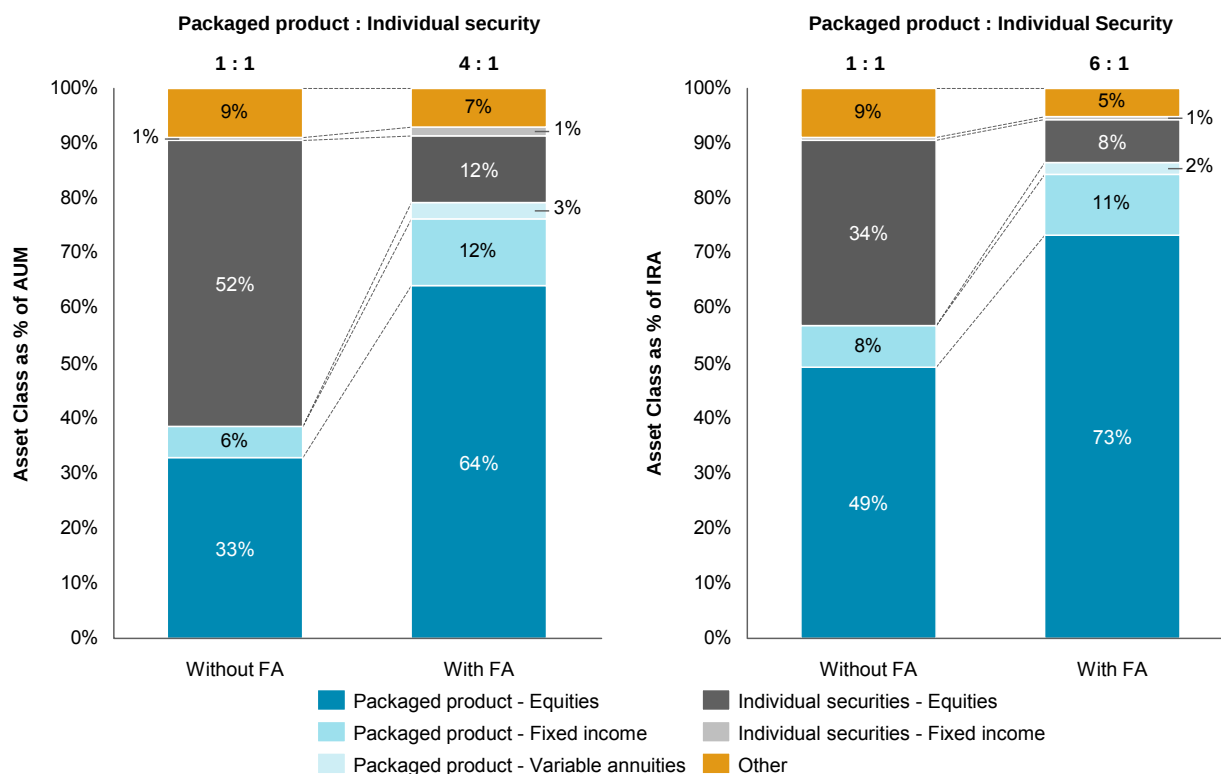


These trends hold true when controlling for age, income, and wealth. Figure 21 shows the findings for one particular segment (i.e. the cohort aged 45-54 with less than \$100,000 in annual income and total wealth, respectively), where the comparison is even more stark. In this case, non-advised individuals hold more than four times as much of their portfolios in individual equity securities vs. equity packaged products.

In the cohort aged 45-54 with less than \$100,000 in annual income and wealth, non-advised individuals hold four times more equity exposure through individual securities compared with advised investors

⁴³ IXI household-level dataset of U.S. Consumer Invested Assets; Oliver Wyman Analysis; percentages may not add up to 100% due to rounding of values

Figure 21: Assets and IRA product mix – Age: 45-54, Income: \$0-100K, Wealth: \$0-100K⁴⁴



D. Staying invested in the market

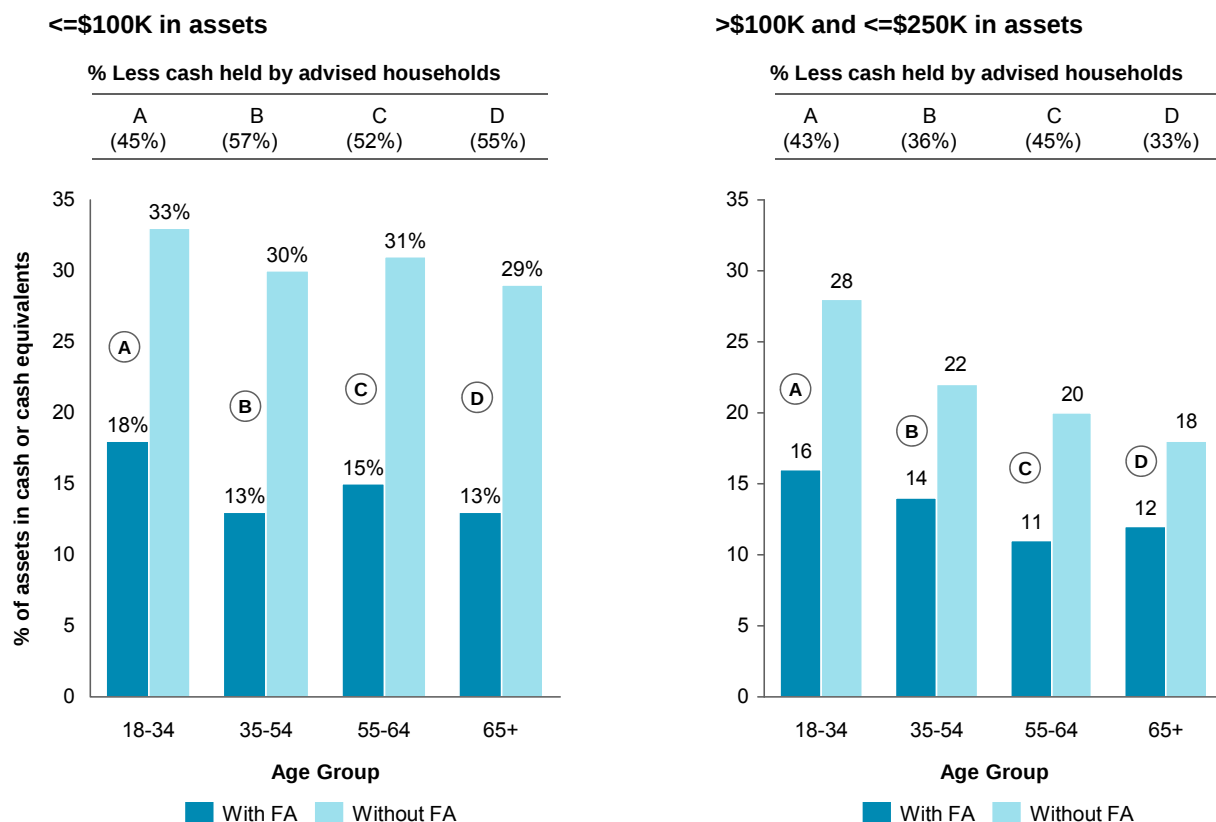
Individuals with a financial advisor hold smaller cash balances – ranging from 36%-57% less than non-advised individuals for similar age and wealth cohorts

In our Retail Investor Retirement Survey, we found that individuals with financial advisors hold a smaller percentage of their non-retirement assets in cash equivalents. As shown below in Figure 22, this finding holds true across all asset and age strata⁴⁵. As cash equivalent holdings have lower real returns, individuals may potentially achieve higher long-term returns by limiting their allocation to cash.

⁴⁴ IXI household-level dataset of U.S. Consumer Invested Assets; Oliver Wyman Analysis; percentages may not add up to 100% due to rounding of values

⁴⁵ The differences observed in cash holdings between advised and non-advised households was significant at a 95% confidence level for all segments except the group aged 65 or older with \$250K-\$ 1MM in assets

Figure 22: Percent of assets held in cash or cash equivalents outside of workplace retirement plans⁴⁶



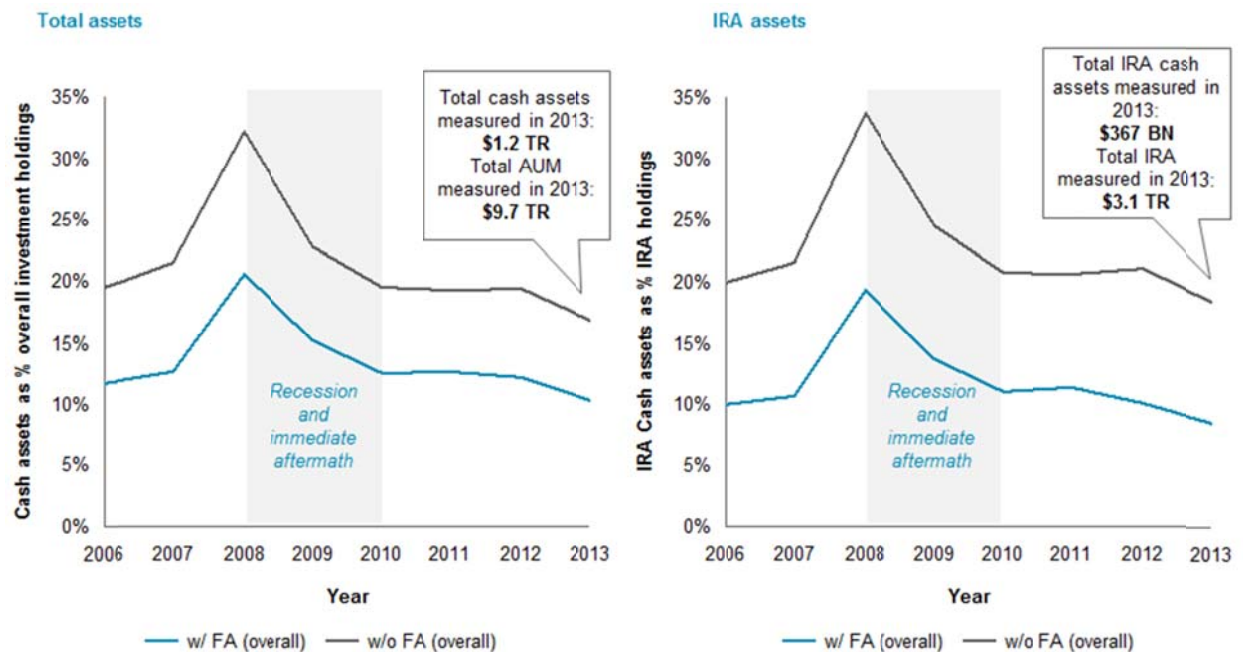
Again, the IXI data supports and expands upon this finding, which holds true over time for both total assets as well as retirement assets in IRA accounts across income, wealth, and age segments analyzed. For example in 2013, nearly 99% of advised households held 25% or more less cash and/or cash equivalents as a percentage of their portfolio compared to non-advised.⁴⁷

Figure 23 depicts this trend for the overall population analyzed.

⁴⁶ Oliver Wyman Retail Investor Retirement Survey

⁴⁷ IXI account-level time series dataset of U.S. Consumer Invested Assets; Oliver Wyman Analysis

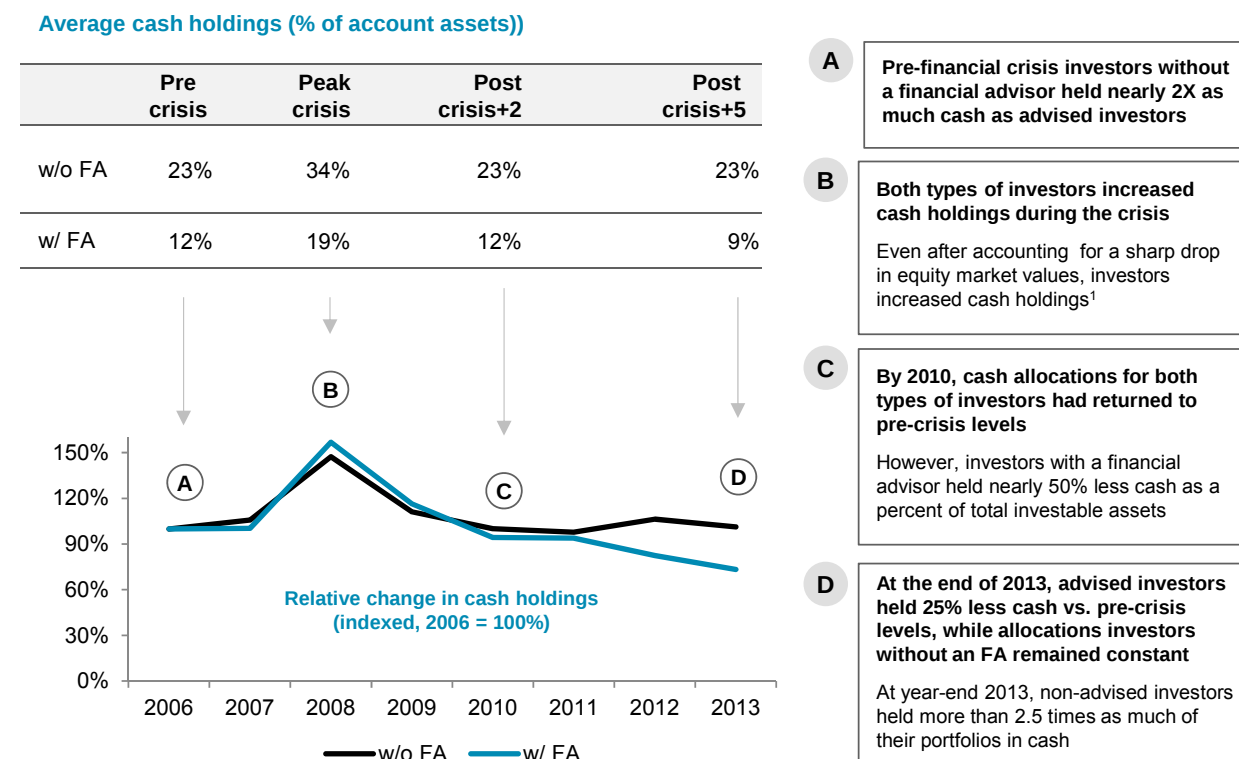
Figure 23: Cash holdings as a percent of account assets for advised and non-advised investors⁴⁸



Analysis of the segment with less than \$100K in wealth and income similarly shows that advised investors held substantially less cash as a portion of total account assets before (48% less), during (44% less) and after the financial crisis (60% by the end of 2013). (Figure 24).

⁴⁸ IXI account-level time series dataset of U.S. Consumer Invested Assets; Oliver Wyman Analysis

Figure 24: Cash holdings as a percent of total account assets for investors with and without a financial advisor – Segment with <\$100K in wealth and income⁴⁹



¹ Cash allocations could have increased without any change in investor behavior due to the large decline in equity markets. We analyzed the magnitude of this potential effect in the following manner. Average advised investor pre-crisis (2007) allocation to equities was 60% while cash holdings represented 12% of investable assets. Assuming (1) no change in portfolio holdings, (2) only equity values changed, and (3) the equities allocation performed similarly to the S&P (as measured by SPY) during the financial crisis, the 38% drop in SPY share price in 2008 could have represented at most 3.5% of the 7% point increase cash holdings, i.e. $.12 / (1 - (0.38 * 0.6)) = .12$. The equivalent figure for non-advised is 8%, i.e. $0.24 / (1 - (0.38 * 0.66)) = 0.24$ of the 10% point increase in cash holdings. Since actual equity allocations dropped by only 40-45% of that predicted in (3) above, the equity market decline is estimated to account for an even smaller portion of increased account cash allocations.

The finding of persistently lower cash allocations for advised investors provides strong evidence that financial advisors help individuals enter and stay invested in the market across market cycles leading, on average and over time, to better investing outcomes.

Excess cash holdings represent a drag on investment performance. However, premature withdrawal of retirement account assets is an even costlier investing behavior that reduces principal and the potential benefit of compounded returns.

⁴⁹ IXI account-level time series dataset of U.S.; Morningstar, Oliver Wyman Analysis

Financial advisors help individuals avoid premature IRA distributions - 76% of heads of households that made traditional IRA withdrawals in 2013 were retired

Tax-advantaged workplace retirement plans provide the greatest benefit when individuals start saving early and continue to save and invest throughout their working years until retirement age. According to a GAO study, “Cashouts [have] the greatest ultimate impact on participants’ retirement preparedness [...] Cashouts of 401(k) accounts at job separation can result in the largest amounts of leakage and the greatest proportional loss in retirement savings.”⁵⁰

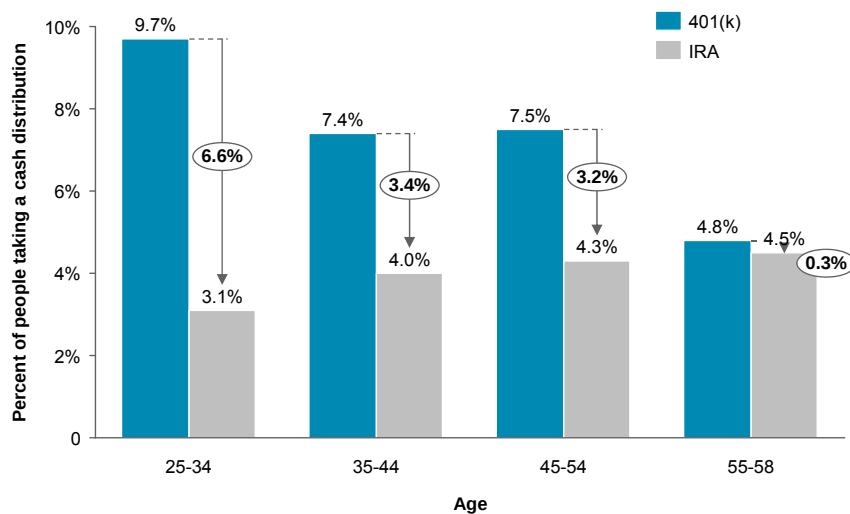
Approximately 9 out of 10 (88%) IRA accounts are held in a brokerage model, where an individual has access to a range of different types of advice and support from a financial advisor.⁵¹ According to ICI, IRA holders tend to keep assets in their accounts until retirement. In 2013, 76% of households that made traditional IRA withdrawals were retired. This stands in contrast with DC plan behavior, where there is a natural triggering event when individuals terminate employment. According to a Vanguard study, 38% of individuals in their twenties took cash distributions upon leaving their employer⁵². Moreover, individuals aged 25-34 were more than three times as likely to take a cash distribution from a 401(k) compared to an IRA when leaving a job. Different distribution rates by age cohort and account type are illustrated in Figure 25.

⁵⁰ Government Accountability Office, ‘401(k) Plans: Policy Changes Could Reduce the Long-term Effects of Leakage on Workers’ Retirement Savings’, August 2009

⁵¹ Oliver Wyman, ‘Assessment of the Impact of the Department of Labor’s Proposed “Fiduciary” Definition Rule on IRA Consumers’, 2011

⁵² Vanguard, ‘How America Saves 2013: A report on Vanguard 2012 defined contribution plan data’, June 2013

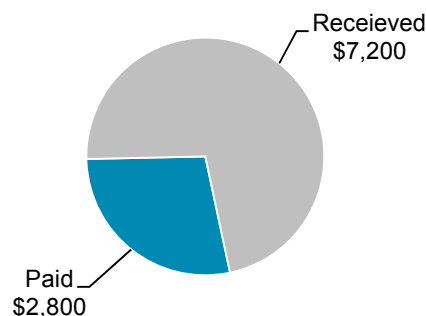
Figure 25: Percentage of individuals taking cash distributions by age and plan type⁵³



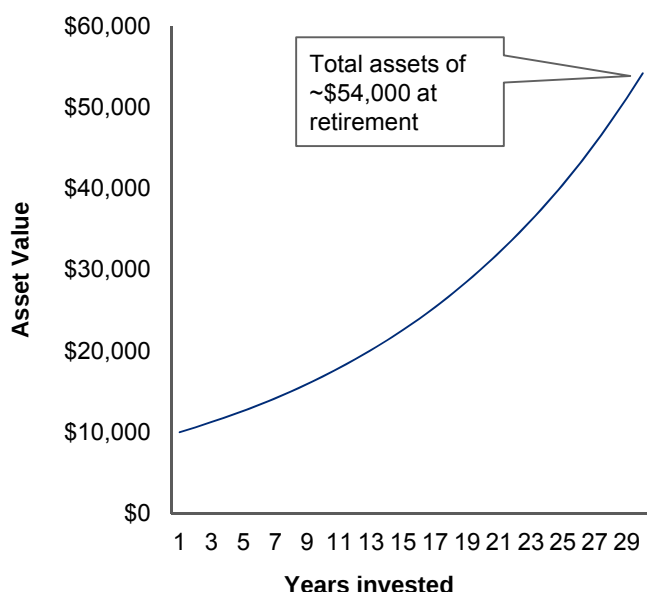
The value of remaining invested is illustrated in a worked example, shown in Figure 26, where we contrast the potential outcomes of two scenarios. In the first scenario, an individual with a \$10,000 account balance takes a cash distribution 30 years prior to retirement. Assuming an early withdrawal penalty of 10%, a federal tax rate of 15% and a state tax rate of 3%, they would have \$7,200 after penalties and taxes. In the second scenario, the individual rolls the same amount of money into an IRA, achieves an average annual return of 6% and is subject to the same combined state and federal 18% tax rate at retirement. In this situation, they would have \$44,280 after taxes, or approximately \$24,500 in current period equivalent dollars, assuming 2% annual inflation – an amount 3.4 times greater.

Figure 26: Worked example comparing a cash distribution with an IRA rollover-Illustrative

Penalty or Tax	Amount
Early Withdrawal Penalty (10% of withdrawal amount)	\$1,000
Required Federal tax withholding	\$2,000
Federal tax withholding refund you should receive	\$500
State tax you will owe	\$300



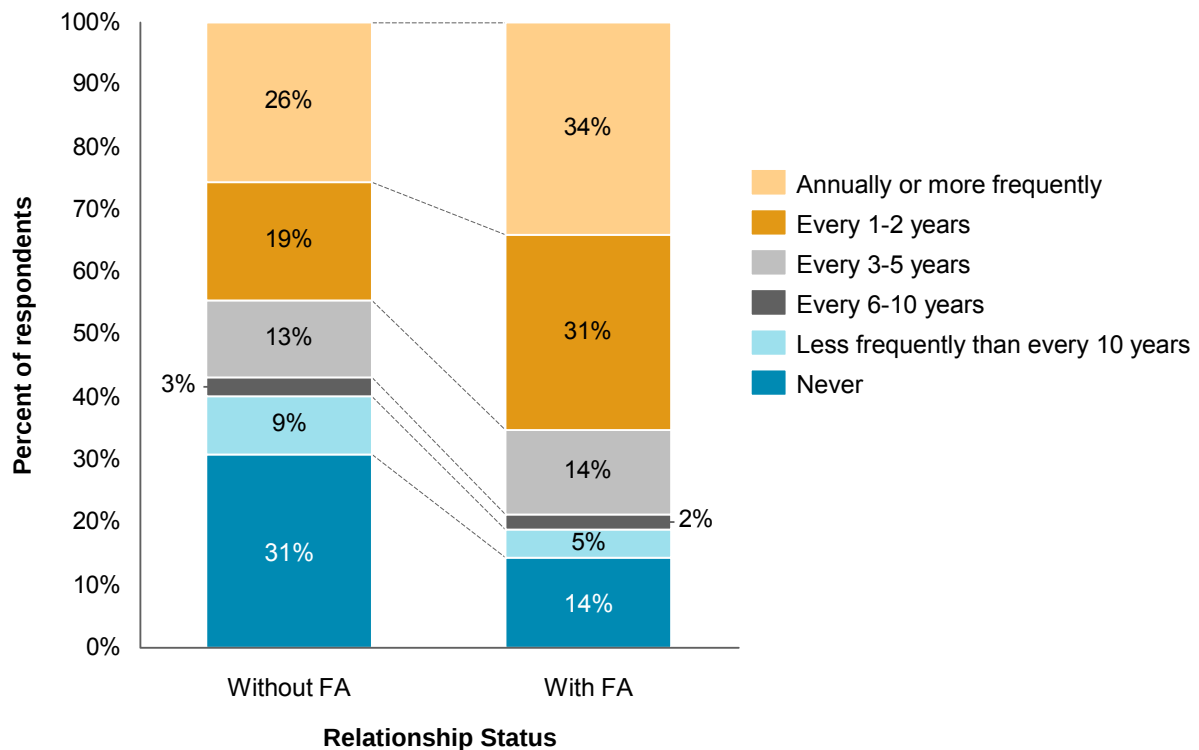
⁵³ Butrica, Zedlewski, Issa, 'Understanding Early Withdrawals from Retirement Accounts', 2010



E. Periodically rebalancing asset holdings to restore desired asset allocation and risk levels – Individuals with financial advisors are 44% more likely to re-balance their portfolios at least every two years

Portfolio re-balancing is an important risk mitigation tool. For example, if an investor's portfolio is valued at \$100,000, divided equally between equities and fixed income, and the equities portion increases in value by 25% while fixed income increases by a more modest 5%, the overall portfolio value increases to \$115,000. In this case, the equities allocation increases from 50% to 54% of the portfolio value, while the fixed income portion decreases from 50% to 46%. Regular re-balancing restores asset allocations to target levels to reflect investors' risk return objectives. In our research, individuals with financial advisors rebalanced their portfolios more often than non-advised individuals. 65% of advised individuals re-balanced at least every two years, compared with 45% for non-advised individuals (a difference of 44%). This is illustrated in Figure 27.

Figure 27: Rebalancing frequency outside of DC plans⁵⁴



* * *

Returning to the original question of the value of a financial advisor, the majority of individuals across wealth and age segments, as well as many small businesses, seek professional financial advice, and value their FA as a trusted advisor. We found substantial evidence that advised individuals are more sophisticated and diligent long term investors who achieve better investing outcomes.

The benefits financial advisors provide are now at risk. On April 14, 2015, the Department of Labor issued its Conflict of Interest rule proposal, a replacement for the

⁵⁴ Oliver Wyman Retail Investor Retirement Survey 2014: A KS test is significant at a 95% confidence level

Definition of the term “fiduciary” rule proposal withdrawn in September 2011.⁵⁵ In our 2011 study reviewing the impact of the previously proposed rule, we concluded that the Department of Labor’s proposed rule change was motivated by a laudable objective: to ensure a high standard of care toward retirement plan participants and account holders with regard to the receipt of services and investment guidance, amid an increasingly complex financial marketplace. However, we found the proposed rule was likely to have serious negative and unintended effects on the very individuals the change was supposed to help.

Many stakeholders are now analyzing the technical details of the newly proposed rule, and there is growing consensus on the implications for financial services providers with regard to the prohibited transaction exemptions newly proposed, modified or absent from the proposed rule. However, with regard to the impact on individuals, regrettably we reach the same overall conclusion as in the prior study. The proposed rule change will likely have significant consequences that will adversely impact individual investors’ ability to save for retirement.

- As proposed, financial advisors would be forced to withdraw workplace retirement plan set-up and support services from small businesses, due to the lack of an exception allowing providers to market to plans with fewer than 100 participants that are self-directed –many small businesses are likely to close or not open plans due to the additional administrative burden as a result. This would directly impact the 19 MM individuals who work for small businesses with fewer than 50 employees, who do not currently have access to a workplace retirement plan by reducing the likelihood these individuals will gain access to a plan in the future
- Individuals with small balance accounts are likely to lose access to retirement help and support with selecting appropriate products. We previously estimated that 7 MM current IRAs would not qualify for an advisory account due to low balances⁵⁶
- Almost all retail investors would face increased costs (73% to 196% on average) from providers shifting clients to a fee-based advisory model. In our 2011 study, we found nearly 90% of the 23 MM IRAs analyzed were held in brokerage accounts⁵⁷

⁵⁵ Definition of the Term “Fiduciary”; Conflict of Interest Rule – Retirement Investment Advice, 80 Fed. Reg. 21928, pp. 21927-21960 (proposed Apr. 20, 2015)

⁵⁶ Oliver Wyman, ‘Assessment of the Impact of the Department of Labor’s Proposed “Fiduciary” Definition Rule on IRA Consumers’, 2011

⁵⁷ Oliver Wyman, ‘Assessment of the Impact of the Department of Labor’s Proposed “Fiduciary” Definition Rule on IRA Consumers’, 2011

- Individuals are less likely to open an IRA, leading to lower savings rates and increased cash-outs when changing jobs⁵⁸
- Unadvised individuals are likely to carry excess portfolio risk due to less diversification and less frequent re-balancing compared with advised individuals

* * *

Retirement is too important to get wrong⁵⁹. We encourage key stakeholders from the financial services industry and regulators to join together to find workable solutions that preserve individuals' access to help and support from a financial advisor of their choosing as well as the business model and fees that best meet their needs.

⁵⁸ Prior guidance from the DOL "held that recommendations to a plan participant to take an otherwise permissible distribution, even combined with a recommendation as to how to invest distributed funds, is not fiduciary investment advice." K&L Gates, DOL Re-Proposes Rule to make Brokers, Others, ERISA Fiduciaries (Apr. 27, 2015), <http://www.klgates.com/dol-re-proposes-rule-to-make-brokers-others-erisa-fiduciaries-04-27-2015>.

⁵⁹ [C]onstraints on the availability of investment services that could result from the DOL's reproposal, particularly for smaller plans or individual retirement investors, can undermine the retirement system in various ways." Sutherland, Legal Alert: DOL Reproposes Expanded ERISA Fiduciary Definition and Revised Complex of Exemptions (Apr. 21, 2015), <http://www.sutherland.com/NewsCommentary/Legal-Alerts/172823/Legal-Alert-DOL-Reproposes-Expanded-ERISA-Fiduciary-Definition-and-Revised-Complex-of-Exemptions>.

Survey methodology

Our small business survey had 1,216 valid complete responses by owners and HR decision makers of payroll-based businesses with between 1 and 100 employees. We employed a stratified sampling approach designed to control for the size of the business and ensure that a sufficient number of businesses were recorded that did and did not consult with financial advisors. Furthermore, we selected three company size cohorts for analysis, namely 1–9, 10–49, and 50–100 employees, based the alignment of these segments with data available on employee retirement plan access for comparison purposes. This design allowed us to isolate the impact that financial advisors have upon small businesses. Where appropriate, we report conclusions that are statistically significant at a 95% confidence level using standard methods of statistical inference.

Our retail investor survey had 4,393 valid complete responses by non-retired individuals with investments or retirement accounts. Responses were excluded from respondents who, at the time of the survey, were: under age 18; retired; not at least partially responsible for financial decision making; and non-investors, meaning they did not have at least one investment or retirement account. In addition, we excluded incomplete responses and those completed in less than 1/3 of the median time to ensure a robust data set. Any figures that we report describe this specific sub-population.

Our stratified sampling approach in this case controlled for age and income as well as the presence of a financial advisor. In designing the sample this way, we strove to control for the effects that age and income have upon investment decisions and retirement planning. However, as our sample does not match the composition of the overall population, we utilize scale factors in our analysis to correct for respondent bias, by underweighting sample responses that are overrepresented relative to the population and vice-versa. Although we sampled based upon age, income and the presence of a financial advisor, we scale our sample to the population using age, assets, and the presence of a financial advisor, as the distribution of household assets is better documented in secondary sources than the distribution of personal income. We obtained the population distribution of household age and assets for FA advised and non-FA advised households from the survey of Consumer Finances, a triennial cross-sectional survey of US families conducted by the Federal Reserve. We utilized the 2013 survey data. We report conclusions that are statistically significant at a 95% confidence level.

Appendix I.

Methodology for analysis of U.S. retail investor assets

Our analysis leveraged IXL Services data containing segment-level detail on U.S. consumer invested assets. Segments were defined by specific age tiers (five), income tiers (eleven), wealth tiers (seven), advisor relationship type (Full Service Brokerage vs. Discount Brokerage) and year. For the purposes of this report, we refer to the Full Service Brokerage relationship as “with financial advisor” and the Discount Brokerage relationship as “without financial advisor.”

IXL data contained information on total segment:

- Assets and IRA holdings
- Asset class distribution
- Number of households / accounts

We used two datasets from IXL, which were distinct in the following ways:

Dataset name	1. Household Point-In-Time	2. Account Time Series
Time period	2012-2013	2006-2013
Count type	Households ⁶⁰	Accounts
2013 Assets	\$5.6 TR	\$9.7 TR
2013 Population	21 MM households	71 MM accounts
Segment criteria	Only households with recorded age, income and wealth segment	Includes accounts with no recorded age

While the age segment criterion was analyzed in the Account Time Series dataset, it was ultimately eliminated to capture a broader representation of US invested assets. This is due to a data limitation whereby only 60% of accounts were associated with a specific age. All findings in this study were confirmed across all age, wealth, income, and time segments in both the Household Point-In-Time and Account Time Series datasets unless indicated otherwise.

Findings were generated by comparing the segment-level averages of the various metrics listed above between the Full Service and Discount Brokerage populations. In drawing conclusions from this granular segment-level comparison, we disregarded segments with fewer than 500 households (Household Point-In-Time) or 500 accounts

⁶⁰ IXL could only aggregate account holdings from a single household within a given institution and could not aggregate households' holdings across institutions

(Account Time Series) to eliminate segments with insufficient data points. This resulted in the exclusion of 0.01%-0.04% of the population.

Appendix II.

Automated solutions to address inertia in retirement plans do not guarantee optimal retirement outcomes

It has been well-documented that retirement outcomes are significantly impacted by the status quo bias that leads DC plan participants to prefer their current state both in terms of non-participation and nature of participation⁶¹. This not only affects contribution rates but also asset allocations, both with respect to rebalancing and following a risk allocation glide path to match investor risk profiles at various ages.

Standard default contribution rates do not appear to generate sufficient asset levels for retirement.

Automatic features can impact participant behavior, a notable example being auto-enrollment features which have been shown to increase plan participation by 45%.⁶⁵ However, while encouraging participation is certainly a step in the right direction, according to EBRI, the most common default contribution rate within a workplace retirement plan was just 3% in 2012⁶². This falls well short of an ideal default path to encourage sufficient retirement savings, which is suggested by Prudential as, “A 5–6% default deferral rate with a 2% annual acceleration up to a cap of at least 10–12%”⁶⁵. Unfortunately, only 21% of plans had an automatic escalation feature in 2013⁶³, leading us to conclude that inertia leads many participants continue to save at sub-optimal default contribution rates.

The illustrated example shown below in Figure 28 confirms that for the average individual, a 3% savings rate results in sub-optimal retirement savings. The example utilizes the median income by age according to the US Census, which assumes that an income of approximately \$36,000 at age 25 grows to an income of \$58,000 at age 65. In addition, we utilize a constant 3% contribution rate consistent with the most common default rate, and 6% annual returns. These assumptions lead to a total asset value of approximately ~\$220,000 at age 65, which at approximately 3.8 times the illustrative ending salary falls short of industry recommendations that suggest that individuals save 8 times their ending salary⁶⁴, or approximately \$460,000 in this case. In order to retire

⁶¹ Overcoming Participant Inertia: Prudential Research:
(http://research.prudential.com/documents/rp/Automated_Solutions_Paper-RSWP008.pdf)

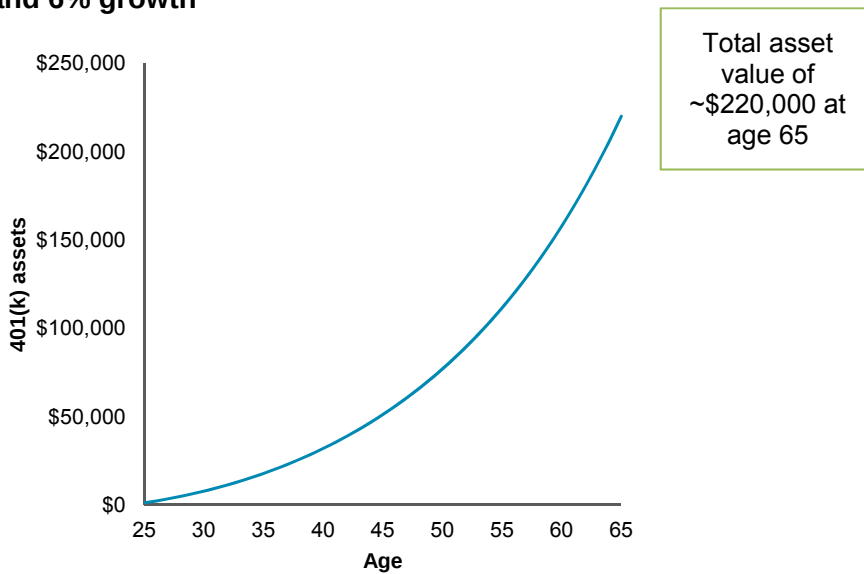
⁶² EBRI September 2012 notes: (http://www.ebri.org/pdf/notespdf/EBRI_Notes_09_Sept-12.HCS-AE.pdf)

⁶³ JP Morgan Asset Management, 2013 defined contribution Plan Sponsor survey Findings: Evolving Toward Greater Retirement Security

⁶⁴ Fidelity Investments, ‘Fidelity Outlines Age-Based Savings Guidelines to Help Workers Stay on Track for Retirement’, September 2012, (<http://www.fidelity.com/inside-fidelity/employer-services/age-based-savings-guidelines>)

comfortably while contributing only 3%, our individual would need to work until age 77. Conversely, contributing an annual average of 6.3% would allow for retirement by age 65.

Figure 28: Example retirement assets by year at median income, 3% contribution rate, and 6% growth



Report qualifications/assumptions and limiting conditions

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APPENDIX 3

COMMENT LETTER TO THE DEPARTMENT OF LABOR

**An Evaluation of the Department's Impact Analysis of Proposed Rules
Relating to Financial Representative Fiduciary Status**

**COMPASS LEXECON
JULY 20, 2015**

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I. BACKGROUND AND SUMMARY OF OPINIONS

1. On April 21, 2015, the Department of Labor (“DOL”) released a “Regulatory Impact Analysis” in support of certain proposed amendments to the rules that identify when a financial representative is deemed to be a fiduciary, as defined in the proposed regulations.¹ The DOL claimed that its proposed amendments “would deliver to IRA investors gains of between \$40 billion and \$44 billion over 10 years,” and that these gains “would far exceed the proposal’s compliance costs, which are estimated to be between \$2.4 billion and \$5.7 billion over 10 years.”²

2. Compass Lexecon was asked by counsel for Primerica, Inc. (“Primerica”) to review the DOL’s Regulatory Impact Analysis and to comment on whether it provides a satisfactory and reasonable economic assessment of the likely costs and benefits associated with the proposed amendments.³ We conclude that it does not. Specifically, we find that the DOL’s analysis grossly overstates the benefits it purports to measure. Moreover, the DOL’s analysis likely understates the costs of the proposed regulation by failing to properly analyze potential unintended consequences. Thus, as a matter of economics, the DOL’s Regulatory Impact

1. Department of Labor (2015) “Fiduciary Investment Advice: Regulatory Impact Analysis,” April 14, 2015 (“DOL Impact Analysis”).

2. DOL Impact Analysis, at 8. The DOL states: “The Department expects the proposal to deliver large gains for retirement investors. Because of data limitations of the academic literature and available evidence, only some of these gains can be quantified. Focusing only on how load shares paid to brokers affect the size of loads IRA investors holding load funds pay and the returns they achieve, the Department estimates the proposal would deliver to IRA investors gains of between \$40 billion and \$44 billion over 10 years and between \$88 and \$100 billion over 20 years.” The DOL goes on to state, “The Department nonetheless believes that these gains alone would far exceed the proposal’s compliance costs, which are estimated to be between \$2.4 and \$5.7 billion over t10 years, mostly reflecting the cost incurred by new fiduciary advisers to satisfy relevant PTE conditions.” Given the DOL’s focus on the \$40 to \$44 billion range, this comment letter also focuses its discussion relating to benefits on the DOL’s analysis of the potential benefits it expects to achieve within IRA investment in front load mutual funds. However, we note that our concern about the reliability of the DOL’s analysis showing \$40 to \$44 billion also apply to the DOL’s presented in Table 3.4.4-1 and Table 3.4.4-2.

3. A description of Compass Lexecon is contained in the Appendix.

Analysis does not constitute a reliable cost-benefit analysis. Moreover, the DOL's conclusion that the benefits of the proposed amendments exceed the costs is not supported by reliable economic analysis.

3. With respect to the purported benefits, the DOL's analysis relies upon a misapplication of findings from the academic literature and a number of vague and unsupported assumptions which call into question its reliability. For example, the DOL estimates a purported dollar benefit estimate relating to IRA investor holdings in front-load mutual funds. This estimate relies critically on a result from a 2013 academic study that explored investment and performance in mutual funds with front-end loads conducted by Christoffersen, Evans and Musto ("CEM").⁴ CEM document an empirical relation between fund flows and performance of front-load mutual funds sold by unaffiliated brokers and the amount of *excess* load shared with unaffiliated brokers. However, the DOL misapplies CEM's findings by incorrectly attributing fund underperformance to the *total* level of the of load fee shared with unaffiliated brokers as opposed to the *excess* load fee shared. Moreover, the DOL goes on to also attribute underperformance to funds sold by *captive* brokers, even though CEM did not find that these funds underperformed.

4. With respect to the potential costs, the DOL's analysis relies upon a number of vague and unsupported assumptions that call into question its reliability. For example, the DOL only offers a dollar cost estimate relating to the most obvious categories of direct costs. The DOL routinely speculates that its estimate is likely overstated but ignores or dismisses additional costs associated with many possible unintended consequences of the proposed amendments.

4. Susan E. K. Christoffersen, Richard Evans, and David K. Musto (2013) "What Do Consumers' Fund Flows Maximize? Evidence from Their Brokers' Incentives," *Journal of Finance* 58(1):201-227.

Examples of unintended consequences include the possibility of higher investor paid fees and lower overall savings by IRA investors.

5. Overall, the DOL's Impact Analysis does not provide the public with a reliable estimate of the net benefit (if any) of the proposed regulatory amendments. The DOL's misapplication of CEM's results leads it to overstate, likely by a large amount, the benefit (if any) of the proposed amendments. Moreover, whereas the DOL admits that the \$40 billion to \$44 billion may not be realized, it provides no reliable economic analysis to demonstrate how the proposed amendments would eliminate or mitigate the underperformance it claims exists. The DOL's reliance on vague and unsupported assumptions and its failure to consider appropriately costs associated with unintended consequences likely lead to an understatement of the true costs of the proposed amendments.

6. A broad consensus exists among economists, including those with a variety of different perspectives on the proper role for government regulation, that accurate cost-benefit analysis is crucial to effective policymaking and promotes democratic ends. For example, Professor Cass Sunstein, who until recently served as administrator of the Office of Information and Regulatory Affairs, wrote:

Cost-benefit requirements are of course most easily justified on economic grounds, as a way of promoting economic efficiency and thus eliminating unnecessary and wasteful public and private expenditures. But cost-benefit requirements also have strong democratic justifications. Indeed, they can be understood as a way of diminishing interest-group pressures on regulation and also as a method for ensuring that the consequences of regulation are not shrouded in mystery but are instead made available for public inspection and review. Some of the strongest arguments for cost benefit requirements are not so much economic as democratic in character.⁵

5. Cass R. Sunstein (1996) "The Cost-Benefit State," University of Chicago Law School Coase-Sandor Working Paper Series in Law & Economics, at 4. *See also* Kenneth J. Arrow, et al. (1996) "Benefit-Cost Analysis in Environmental, Health, and Safety Regulation: A Statement of Principles," American Enterprise Institute, The Annapolis Center, and Resources for the Future, at 3 ("Benefit-cost analysis should play an important role in informing the decisionmaking process, even when the information on benefits, costs, or both is highly

7. A failure to accurately measure costs and benefits has the potential to cause waste, to result in misdirected resources, and to harm the basic functions of government in society. Historically, the importance of accurate cost-benefit analysis has been most noted with respect to environmental, health, and safety regulations, but there is today growing recognition that the same principles apply to financial regulations. For example, Eric Posner, the Kirkland and Ellis Distinguished Service Professor of Law and the Arthur and Esther Kane Research Chair at the University of Chicago Law School concludes:

The importance of developing methods for benefit-cost analysis for financial regulation can scarcely be overstated. In recent years, courts have awakened to the fact that many such regulations lack a sound economic basis and have started blocking them.⁶

II. THE DOL'S ANALYSIS OF PURPORTED BENEFITS IS OVERSTATED AND UNRELIABLE

8. The DOL's \$40 billion to \$44 billion estimate of purported benefits is overstated and fatally flawed for at least three reasons:

- The DOL misapplies findings from the academic literature in its estimate of the amount of underperformance potentially associated with conflicted advice.
 - o First, the DOL incorrectly asserts that the level of underperformance associated with purportedly conflicted advice in front-load mutual funds is proportional to the *total*

uncertain ... The estimation of benefits and costs of a proposed regulation can provide illuminating evidence for a decision, even if precision cannot be achieved because of limitations on time, resources, or the availability of information.") See also W. Kip Viscusi (1996) "Economic Foundations of the Current Regulatory Reform Efforts," *Journal of Economic Perspectives* 10(3):119-34, at 120 ("Unless mechanisms exist for placing bounds on our risk reduction efforts, we can end up pursuing policies of diminishing marginal impact and diverting resources from more productive uses.")

6. See, e.g., Eric Posner and E. Glen Weyl (2013) "Benefit-Cost Analysis for Financial Regulation," *American Economic Review* 103(3): 393-397, at 397

- load that goes to the broker when the literature cited demonstrates that underperformance (if any) is only related to the *excess* load that goes to the broker.
- o Second, the DOL incorrectly asserts that front-load mutual funds sold by captive brokers underperform as a result of conflicted advice when the literature cited does not find evidence of underperformance.
 - The DOL ignores findings from the academic literature suggesting that underperformance may be limited to certain investment categories (e.g., U.S. equity, bonds, foreign equities, etc.) of mutual funds and need not be present in all mutual funds.
 - The DOL assumes that the proposed regulatory amendments will mitigate or eliminate underperformance without providing any reliable economic analysis demonstrating that such an outcome is likely.

A. THE DOL MISAPPLIES FINDINGS FROM THE ACADEMIC LITERATURE

9. The DOL performs a simulation of expected IRA-related savings amounts over the 10 year investment horizon beginning in 2017 and ending in 2026 to calculate the purported \$40 billion to \$44 billion in expected gains.⁷ Specifically, the simulation compares aggregate IRA-related savings in front-load mutual funds under a “Baseline Scenario” without the proposed regulatory amendments to various “Alternative Scenarios” which make different assumptions as

7. DOL Impact Analysis, at 113. The DOL also extended the analysis to 20 years, out to 2036. The same concerns we raise below apply equally to this longer-duration estimate. The DOL also claims that there may be other benefits beyond those quantified, including “improvements in the performance of IRA investments other than mutual funds and potential reductions in excessive trading and associated transaction costs and timing errors (such as might be associated with return chasing).” *Id.*, at 235. However, the DOL has provided no support for any of these claims, nor any quantification of the claimed benefits. As discussed below, one likely result of the proposed amendments would be to push some IRA investors into less tax-advantaged savings accounts. IRAs, unlike taxable savings accounts, impose a substantial penalty for early withdrawal, and as a consequence, investors in taxable savings accounts may have weaker incentives to resist early withdrawal. Therefore, there are plausible reasons why the proposed amendments could have the opposite effect as claimed by the DOL, namely, to incentivize early withdrawal of retirement savings, and the loss of subsequent compounding of returns.

to the benefits of the regulatory amendments. The \$40 billion to \$44 billion in expected savings is calculated as the difference in the predicted total IRA related savings in front-load mutual funds between two of the Alternative Scenarios and the Baseline Scenario.

10. The difference in IRA-related savings in front-load mutual funds results from the DOL's *assumption* that investors will earn higher investment returns in the Alternative Scenarios than in the Baseline Scenario. For example, the DOL assumes that, if the proposed amendments are finalized, IRA investors' front-load mutual fund holdings will experience investment returns between 5.17 percent and 5.91 percent per annum under the Alternative Scenarios. However, absent the regulatory amendments, the DOL assumes that IRA investors' holdings will only grow at rates between 5.07 percent and 5.46 percent per annum.⁸

11. The DOL rationalizes this difference in returns by appealing to the results from a regression analysis published in a 2013 academic paper by CEM. Specifically, the DOL asserts:

An estimate from CEM suggests that for every 100 basis points of the load that go toward an unaffiliated broker's load share, an IRA investor can expect to experience a decrease in performance of 49.7 basis points. For every 100 basis points of the load that go toward a captive broker's load-share, an IRA investor can expect to experience a decrease in performance of 14.5 basis points.⁹

12. Next, the DOL weights the 49.7 basis points and 14.5 basis points estimates by what it claims are the market shares of overall investment in front-load mutual funds sourced from unaffiliated and captive brokers. The DOL concludes that *each 100 basis points in the amount of load received by a broker* is associated with a weighted average reduction of 44.94 basis point

8. DOL Impact Analysis, at 105 & 113. The DOL analyzes three Alternative Scenarios. As part of its third scenario, the DOL speculates that, as consequence of the proposed amendments, "loads paid by investors immediately fall to zero." *Id.*, at 104. However, the DOL immediately discounts the likelihood of this outcome, and the results of this scenario are not a part of the DOL's conclusion that the benefits of the proposed amendments are \$40 billion to \$44 billion.

9. DOL Impact Analysis, at 114.

in IRA returns.¹⁰ The DOL then uses this 44.94 basis point estimate as an input in its calculation of the increase in the return performance the DOL assumes will result from the proposed amendments. Thus, the reliability of the 44.94 basis point estimate and the implementation of that estimate in the DOL's benefit calculation is a critical component of the DOL's analysis.

13. The DOL applies the 44.94 basis point estimate to its estimate of the *total load* that goes toward the broker's share to determine the amount of underperformance to be used in its simulation study.¹¹ Specifically, the DOL assumes that front-load mutual funds will experience 44.94 basis points in improved performance as a result of the proposed regulatory amendments for every 100 basis points of *total load* that goes toward the broker. For example, in 2017, the DOL estimates that the average total load that goes toward the broker is 134 basis points. In the Baseline Scenario, the DOL assumes that new investment in 2017 into front-load mutual funds will result in underperformance of 60.22 basis points – 134 basis points times 44.94 basis points divided by 100 equals 60.22 basis points. The DOL assumes that new investments made under the Alternative Scenarios will not experience this 60.22 basis point in underperformance because of the proposed regulatory amendments. The DOL attributes the difference to a purported benefit.

14. However, a review of CEM reveals that CEM's point estimates of 49.7 and 15.4 basis points are associated with the *excess load* that goes toward a broker's load share and not the *total load* that goes toward the broker's load share.¹² *Excess load* is defined by CEM as the load

10. DOL Impact Analysis, at 114.

11. The DOL's estimates of the total load that goes toward the brokers share are provided in DOL Impact Analysis, at Table 3.4.1-1 in columns (B) and (C).

12. See, for example, Christoffersen, Evans, and Musto (2013) *op. cit.*, at 226 (Table V, entitled "Future Returns and Excess Load Paid to Broker"). See also, for example CEM at 225 quoted herein for exposition: "Do the funds that pay brokers more subsequently perform better or worse? To address this question we run multiple regressions with the excess load paid to the broker and excess revenue sharing explaining performance over the next 12 months."

received by the broker, *net of a baseline load amount* for funds in the same category (*e.g.*, “Equity,” or “Fixed Income”), and with similar attributes (*e.g.*, size of total load, mutual fund family size, or fund size).¹³ CEM’s focus on *excess load* reflects a hypothesis that a poorer-performing fund may be able to compete by offering brokers *additional* load payments relative to otherwise similar funds, not any claim that all load payments to brokers reflect lower returns.¹⁴

15. Thus, the DOL misapplies its 44.94 basis point estimate derived from CEM to its estimate of the *total load* that goes toward the broker’s share as opposed to an estimate of the *excess load* that goes toward the broker’s share as originally estimated by CEM. This misapplication of CEM results in an *overstatement* of the purported benefits actually estimated. To see why, consider the following example. Suppose a certain mutual fund in 2017 charges 164 basis points in a front-end load and that the fund shares 134 basis points with a broker as estimated by the DOL.¹⁵ CEM’s regression analysis applies *only* to the amount of *excess* in load fees shared with the broker relative to similar mutual funds. For example, if other funds similar to the fund in question levy an average of 150 basis points in front-end load fees and pay 122 basis points to unaffiliated brokers, then the *excess load* shared for the fund in question (relative to other funds) is only 12 basis points (134 basis points minus 122 basis points equals 12 basis points of excess load shared).¹⁶ Using a proper estimate of excess load shared compared to the total load shared results a reduction in the estimate amount of underperformance from the 60.22

13. Christoffersen, Evans, and Musto (2013), *op. cit.*, at 216-218.

14. Indeed, CEM state “Flows and returns vary over time and across funds for many reasons, and these reasons could also be important for broker payments. For example, flows, payments, and returns could all be higher for equity funds.” Christoffersen, Evans, and Musto (2013), *op. cit.*, at 216.

15. This example is modeled after the DOL’s prediction that the baseline average load paid by IRA holders will be 164 basis points and the baseline average load share paid to brokers will be 134 basis points in 2017. See DOL Impact Analysis at 113.

16. For ease of exposition, we refer to the load predicted using CEM’s regression model as the average load paid by similar funds. Technically speaking, the proper implementation would be to use CEM’s regression model to fit a predicted load and then to derive the excess load by subtracting the predicted load from the actual load.

basis points assumed by the DOL to only 5.39 basis points—12 basis points times 44.94 divided by 100 equals 5.39. That is, the DOL’s misapplication overestimates the amount of underperformance—and hence, the gains from the proposed amendments—by more than a factor of 11 in this example.

16. Because the DOL applies the 44.94 basis point figure to the total load that goes toward the broker, the DOL’s estimate of the improvement in return performance assumed to follow the implementation of the proposed amendments is dramatically overstated. Moreover, the overstatement in the improvement in return performance is roughly proportional to the estimated dollar amount of purported benefits because the vast majority of the estimated benefits are derived from the assumed improvement in performance.

17. While the actual overstatement of the gains from the proposed amendments would vary from the example above depending on the amount by which a fund’s total broker load payments constitute an *excess* load shared, it is guaranteed that the overstatement is large. This is because an individual fund’s excess loads are defined relative to the total loads of other funds. Thus, only *some* funds can even have *excess* loads, and therefore, only *some* funds can suffer reduced performance as a result of the alleged conflicts of interest. However, the DOL implicitly assumes that *all* front-loads experience excess loads when, as a matter of statistics, as many as *half* of the funds analyzed by CEM may be expected to lack the requisite *excess* load.

18. Separately, the DOL also misapplies the findings of CEM in attributing a 14.5 basis point reduction in investment performance to mutual funds that are sold by captive brokers. (As noted above, the 14.5 basis point figure is used by the DOL as part of the calculation in deriving the critical 44.94 basis point assumption.) While it is true that the point estimate related to captive brokers in CEM’s regression is 14.5 basis points, this point estimate is *not* statistically different

from zero – a finding commented on directly by CEM but ignored by the DOL.¹⁷ That is, CEM’s results indicate that they did not find reliable statistical evidence of underperformance within captive broker front-load funds. The DOL ignores this finding and instead simply assumes that this underperformance exists.

19. Moreover, other evidence in CEM further demonstrates the unreliability of the DOL’s application of the 14.5 basis points. In particular, CEM demonstrate that funds sold by captive brokers do *not* exhibit increased inflows as a result of load sharing arrangements—suggesting the conflicted advice does not play a role in investments recommended by captive brokers. In fact, CEM report that *excess* load payments to captive brokers *reduce* fund inflows.¹⁸ The fact that CEM do not find evidence that *excess* load contribute to captive broker fund inflows is entirely inconsistent with the DOL’s assumption that load-sharing agreements in captive brokered funds incentivize captive brokers to steer customers toward these funds.

B. THE DOL IGNORES OTHER FINDINGS FROM THE ACADEMIC LITERATURE

20. The DOL asserts that other literature is consistent with the CEM results in “direction and magnitude”¹⁹ but this assertion is misleading. For instance, another article cited by the DOL,²⁰ by Bergstresser, Chalmers, and Tufano (2009) (“BCT”), concludes that while broad U.S. equity and bond funds underperform relative to direct-marketed U.S. equity and bond funds over a particular period of time, there is only *mixed* evidence of underperformance in foreign equity

17. Christoffersen, Evans, and Musto (2013) *op. cit.*, at 228 (“the coefficient on captive brokerage is not statistically significantly different from zero”).

18. Christoffersen, Evans, and Musto (2013), *op. cit.*, at 220 (Table III).

19. DOL Impact Analysis, at 118.

20. DOL Impact Analysis, at 95.

funds and *no* evidence of underperformance in money market funds.²¹ If the results of BCT apply to front-load mutual funds, then a potentially large subset of front-load funds examined by the DOL may not experience the underperformance assumed by the DOL. If so, then once again the DOL has overestimated the prevalence of underperformance even with unaffiliated brokered funds and by doing so, the DOL potentially further overstates the benefits of the proposed amendments.

C. THE DOL ASSUMES BENEFITS IT PURPORTS TO ESTIMATE

21. Notwithstanding the considerations described above, which all render the DOL benefit analysis unreliable and overstated, the *critical* question on the table is not analyzed by the DOL. Namely, would the proposed amendments mitigate or eliminate the underperformance, if any, experienced within front-load mutual funds that share excess loads with brokers? This question is central to the issue at hand given that the vast majority of the purported gains quantified by the DOL relating to front load mutual funds, even in the second scenario, result from an assumption by the DOL that the amendment will increase returns in front-load mutual funds.²²

22. As noted above, the benefit estimated by the DOL derives from their assumption that the proposed regulatory amendments will mitigate or eliminate underperformance in front-load mutual funds. Importantly, the DOL fails to provide any analysis to demonstrate how the amendments in question will achieve this outcome. Instead, the DOL only suggests that mutual

21. Bergstresser, Chalmers, and Tufano (2009) “Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry,” *Review of Financial Studies* 4129–4156, at 4138-9 (Table 3) and the discussion at 4140-1.

22. DOL Impact Analysis, at 105 (“Under the second reform scenario, the effect on investment performance constitutes approximately 90 percent of the estimated gain.”) In addition, under certain Alternative Scenarios, the DOL also assumes that IRA investors will experience the additional benefit of paying lower total loads due to the proposed amendments (DOL Impact Analysis, at 105). This claim is entirely unsupported by any reliable analysis. Notwithstanding the lack of support, the DOL assumes includes this secondary benefit in its estimate of \$40 billion to \$44 billion.

funds will in some way be more strongly incentivized to “invest in performance” if advisers’ conflicts of interest are ameliorated.²³ It is unclear what the DOL means by investing in performance, but in any case, the DOL’s impact statement includes no analysis or any reference to other literature demonstrating that funds do not currently attempt to maximize performance, that they could make additional investments that would increase performance materially, or where the money for this additional investment would come from.

23. Moreover, it is unclear whether the DOL believes that this increase in performance would be pervasive throughout the industry, suggesting that even firms that do not underperform today will improve in performance, or whether the increase would be limited to only those funds that currently underperform. In the case of the former, this assumption borders on irrational. If it is the latter, the DOL analysis fails to identify a reasonable mechanism by which current underperforming funds will be disciplined to improve performance. While one potential form of discipline could come from a shift in financial advisers’ tendencies to recommend underperforming funds, this disciplining mechanism can only work if (1) IRA investors consult with financial representatives, (2) these representatives advise them to reallocate their investments, and (3) the investors follow that advice. However, the DOL has provided no study documenting the frequency with which investors consult with financial professionals or the frequency with which those professionals provide guidance that is followed.

24. Moreover, and perhaps most importantly, none of the literature cited by the DOL claims that the proposed amendments or any similar policy would lead to higher investment returns. Simply stated, the literature cited by the DOL does not support its speculative conclusions.

23. DOL Impact Analysis, at 115.

D. TAKE-AWAY ON THE DOL’S PURPORTED BENEFIT ANALYSIS

25. Overall, the DOL’s purported benefit analysis suffers several flaws: it misapplies findings from the academic literature used to substantiate its claims; it ignores findings in the literature indicating underperformance may not be as widespread as suggested by the DOL; and it assumes the benefits it purports to estimate. Each of these flaws is critical and leads to the conclusion that the DOL’s benefit analysis is unreliable and overstates the benefits purported to be measured. Perhaps telling of overstatement, the DOL also repeatedly speculates that a substantial portion of these gains, such as 75 percent or 50 percent, will be realized.²⁴ To date, the DOL has not provided any analysis to rule out the possibility that none of the gains it envisions will actually be realized.²⁵

III. THE DOL’S ANALYSIS OF PURPORTED COSTS IS LIKELY UNDERSTATED AND UNRELIABLE

26. The DOL’s \$2.4 billion to \$5.7 billion estimate of purported compliance costs is most likely understated and fatally flawed for at least three reasons:

- The DOL only estimates the most direct and obvious costs, while improperly dismissing other costs likely to be incurred by market participants, including the government.
- The DOL improperly dismisses costs likely to be incurred due to unintended consequences.
- The DOL routinely relies on assertions about potential cost levels when reliable data analysis is required.

24. DOL Impact Analysis, at 8, 101-2, 106, & 216.

25. As noted previously, our concerns about the reliability of the DOL’s analysis showing \$40 to \$44 billion also apply to the DOL’s presented in Table 3.4.4-1 and Table 3.4.4-2.

A. THE DOL TOO READILY DISMISSES COSTS LIKELY TO BE INCURRED BY MARKET PARTICIPANTS, INCLUDING THE DOL ITSELF

27. The DOL estimates costs of the proposed amendments in four specific categories: “Firm Costs,” “E&O Insurance,” “Switching/Training Costs,” and “Additional PTE/Exception Costs.”²⁶ According to the DOL, the total cost of compliance with the proposed amendments over 10 years in these four categories is expected to be between \$2.4 billion and \$5.7 billion, a range which reflects two different scenarios regarding “Firm Costs” and two different assumed discount rates over the 10 year period.²⁷ However, the DOL dismisses or completely ignores the likelihood of unintended consequences from the proposed amendments that are likely to be incurred by market participants that could substantially increase costs.

28. In describing its cost estimates, the DOL repeatedly suggests that the estimates are likely to overstate the actual costs of the proposed amendments, but only rarely mentions any reasons why its estimates might understate the actual costs of the proposed amendments.²⁸ Importantly,

26. DOL Impact Analysis, at 178.

27. DOL Impact Analysis, at 178.

28. See, e.g., DOL Impact Analysis, at 157-8 (“The Department believes the higher end of the estimated cost range represents an over-estimate, because it implicitly assumes that existing business models will change only as necessary to come into compliance, and will retain their existing market shares, when in fact new, more cost-effective business models are already gaining market share, and the new proposal is likely to encourage such market improvements ... The lower end of the estimated range incorporates lower available bases, but should not be interpreted as a lower bound because it likewise neglects such ongoing market improvements and the new proposal’s positive effects thereon”); DOL Impact Analysis, at 164 (“Scenario A likely overstates the costs of the proposed regulations and exemptions by a substantial margin. Scenario B is a more reasonable estimate, but probably also overstates the costs because of the flexible standards-based approach of the Department’s new proposal, which would enable firms to comply in the most cost-effective way in light of their current practices and systems”); DOL Impact Analysis, at 166 (“As discussed above even these estimates are believed to be overestimates, possibly by a large margin”); DOL Impact Analysis, at 165 (“[U]sing the IAA ration could lead to an over-estimate of small firms costs, particularly for start-up costs”); DOL Impact Analysis, at 167 (“Subsequent year costs could be even lower as firms already conduct training of their staff”); DOL Impact Analysis, at 174 (“[S]ome of these costs would be offset by firms and individuals that would no longer be required to register as BDs or their representatives”); DOL Impact Analysis, at 215 (“Much of the estimated compliance cost is associated with satisfaction of PTE conditions. The number of advisers who will take advantage of the relevant PTEs is uncertain, however. Some advisers may find it more advantageous to simply avoid PTs. The Department has aimed to err on the side of overestimating the compliance costs”).

the DOL repeatedly dismisses other potential categories of costs likely to be incurred by firms and employees in the industry, including those associated with call centers,²⁹ creating or updating contracts,³⁰ and search and training for advisers left unemployed.³¹ The DOL also dismisses any costs imposed on financial product providers³² and costs paid by the government to implement and enforce the proposed regulations.³³

B. THE DOL IMPROPERLY DISMISSES COSTS RELATED TO OTHER UNINTENDED CONSEQUENCES

29. In contrast with the DOL’s assumption of no costs for the proposed amendments beyond those that are immediate and obvious, the academic literature on regulation demonstrates that well-meaning regulations very frequently have important unintended consequences that lead to additional costs (and/or reduced benefits) relative to what was expected.³⁴ Unintended consequences are even more likely—and potentially more costly—in the case of financial regulation because financial markets serve as an important conduit for the efficient allocation of resources throughout the economy, and therefore touch many other markets. As one study noted, “The history of U.S. financial regulation, in many respects, is a history of unanticipated

29. DOL Impact Analysis, at 175.

30. DOL Impact Analysis, at 176.

31. DOL Impact Analysis, at 176, 227.

32. DOL Impact Analysis, at 176-7.

33. DOL Impact Analysis, at 215.

34. Some famous examples of unintended consequences leading to additional costs in the literature include: Richard A. Posner (1974) “The Social Costs of Monopoly and Regulation,” *Journal of Political Economy* 83(4):807-27; Sam Peltzman (1975) “The Effects of Automobile Safety Regulation,” *Journal of Political Economy* 83(4):677-726; Robert W. Crandall and John D. Graham (1989) “The Effect of Fuel Economy Standards on Automobile Safety,” *Journal of Law & Economics* 32(1):97-118; and John DiNardo and Thomas Lemieux (2001) “Alcohol, Marijuana, and American Youth: The Unintended Consequences of Government Regulation,” *Journal of Health Economics* 20(6):991-1010.

consequences.”³⁵ In this case, the proposed amendments would impact the provisioning of IRAs, which the DOL projects would involve approximately \$9 trillion in individual savings.³⁶

30. An important category of potential unintended consequences for any regulation that imposes costs on firms (as the DOL admits the proposed amendments do) is higher prices charged to consumers by these firms and the reduced purchasing. Basic economics indicates that any regulation that increases an industry’s costs of serving consumers will lead to higher prices and lower output.³⁷

31. All else equal, economic theory predicts that fees charged to investors will rise when additional costs are imposed on firms in the industry for at least two reasons. First, the costs imposed on advisers and advisory firms operating in the industry will be passed on (at least in part) to investors in the form of higher fees.³⁸ Moreover, higher costs can cause firms to exit the industry or to exit certain segments of the industry, leading to a weakening of the competition that otherwise would drive down fees. As a result, investors facing higher fees would, in turn, likely invest less, or alternatively select other forms of investment that do not have these higher costs and potentially are less tax advantaged.

32. For example, we understand that participants in this rulemaking have indicated that the proposed regulatory amendments will cause certain firms within the industry to significantly curtail their efforts to attract IRA investors with balances below \$25,000. If so, then there would be less competition in the industry for investors that wish to start a new IRA or roll-over another retirement account with a balance below \$25,000. In this instance, fees to these customers may

35. Charles K. Whitehead (2012) “The Goldilocks Approach: Financial Risk and Staged Regulation,” *Cornell Law Review* 97:1267-1308, at 1268.

36. DOL Impact Analysis, at 115 (citing Cerulli Associates, “Retirement Markets 2014.”)

37. Hal R. Varian (2014) *Intermediate Microeconomics*, 9th ed., W. W. Norton & Co., at 438-9.

38. Jeremy I. Bulow and Paul Pfleiderer (1983) “A Note on the Effect of Cost Changes on Prices,” *Journal of Political Economy* 91(1):182-5.

increase. Moreover, the reduction in client service could result in a reduction in the amount of money that today's consumers save in tax deferred IRA accounts. As noted in a separate Compass Lexecon comment, investors that are forced to abandon IRAs as saving vehicles may face an effective tax increase of 32.9 percent or more.³⁹ But more generally, given the size of total IRA investments in the U.S., even a small reduction in the total amount of IRA investment as a consequence of higher fees has the potential to generate costs to investors that would dwarf the DOL's estimates of the benefits of the proposed amendments.⁴⁰

33. The DOL only briefly addresses these potentially enormous costs associated with lost savings. First, the DOL speculates that new, competitive advisory businesses may enter the industry due to the proposed amendments, thus eliminating any lost savings.⁴¹ However, this claim is inconsistent with commonly accepted economic theory, which teaches that increased costs can create barriers to entry that reduce, not increase, entry by potential competitors.⁴² In this context, the proposed amendments would, as the DOL admits, impose additional costs on firms. Larger firms may be able to achieve profitability even with these new costs because of their scale of operations. However, smaller firms may be more likely to struggle, and hence, more likely to exit the industry. At the same time, new entrants are typically smaller firms, and the increased costs imposed by the proposed amendments similarly affect their incentives to

39. Compass Lexecon (2015) "Comment to the Department of Labor on a Proposed Rule Regarding Investment Adviser Fiduciary Status: Tax Consequences to IRA Investors," July 20, 2015 at 2.

40. Even assets that remained in 401(k)s or other company plans as a consequence of higher IRA adviser fees could reflect losses due to the proposed amendments, since academic literature indicates these accounts are often highly undiversified, whereas IRAs allow a broader range of investments, leading to greater diversification benefits. Schlomo Benartzi (2001) "Excessive Extrapolation and the Allocation of 401(k) Accounts to Company Stock," *Journal of Finance* 56(5):1747-64.

41. DOL Impact Analysis, at 222 & 228.

42. Dennis W. Carlton and Jeffrey M. Perloff (2005) *Modern Industrial Organization*, 4th ed., Pearson Addison-Wesley, at 79-80.

enter the industry. These effects reduce competition, to the detriment of the IRA investors the DOL seeks to protect.⁴³

34. The DOL also suggests that any reduction in investment due to the costs imposed by the proposed amendments might be offset by increased investment due to greater investor trust in fiduciary advisers.⁴⁴ This claim seems to reflect a notion that, while the proposed regulations will reduce the supply of advice, they will also increase the demand for advice from investors who recognize the better value provided by unconflicted advisers. Such a notion is at least ironic, given that the entire rationale for the proposed amendments is that investors are currently subject to “abuse” by apparently being *too reliant* on conflicted advice.⁴⁵ That is, the DOL argues the regulation is needed because investors are too reliant on their financial advisers, but at the same time, the regulation would increase that reliance, driving investors to demand even more advice.

35. Moreover, the DOL claims that “retail investors generally and IRA owners in particular ... cannot effectively assess the quality of the investment advice they receive or even the investment results they achieve ... Individuals over the age of 55 often ‘lack even a rudimentary understanding of stock and bond prices, risk diversification, portfolio choice, and investment fees.’”⁴⁶ However, the DOL fails to explain why the same unsophisticated investors the DOL

43. The DOL describes at length its view that so-called “robo-advisers” will, over time, gain market share from traditional advisory firms. The DOL notes that robo-advisers have lower costs and, at least to date, offer largely unconflicted advice. DOL Impact Analysis, at 230-1. The DOL speculates that, absent the proposed amendments, robo-advisers may become conflicted through competition with traditional advisory firms, which it claims provide more conflicted advice. *Id.*, at 232. The DOL does not explain why the growth of these allegedly unconflicted robo-advisers does not demonstrate that market forces in the current regulatory environment serve to ameliorate conflicts of interest. Nor does the DOL explain its view that increased competition between firms in the future will reduce market efficiency, when the standard presumption in economics is that increased competition increases efficiency.

44. DOL Impact Analysis, at 222 & 228.

45. DOL Impact Analysis, at 59.

46. DOL Impact Analysis, at 59-60.

describes would nevertheless understand the implications of a complex new regulation regarding fiduciary status, and as a consequence, seek to invest more with their advisers.

36. More generally, the DOL fails to fully consider outcomes that have occurred to date from regulation with similar aims to the proposed amendments, such as the Retail Distribution Review (“RDR”), which was implemented in 2013 in the United Kingdom.⁴⁷ While there are a number of differences between RDR and the proposed amendments, the available evidence to date appears to indicate higher investment fees as a consequence of RDR and mixed results regarding the number of advisers and regarding investors’ access to advice.⁴⁸

37. In addition to the potential consequences associated with increased consumer fees and the potential for reduced savings in tax-preferred IRAs, the DOL also does not consider at all a wide range of other potential costs. For instance, the DOL has not fully assessed the likely changes in the structure of payments to advisers, claiming only that an arbitrary number may switch to asset-based fee structures.⁴⁹ In some instances, a move to asset-based fee structures could lead require investors to pay the same or more in fees as the amount of money they purported save from avoiding underperformance.

38. Moreover, the proposed regulatory amendments may change the type of advice offered by advisers. For example, risk-averse financial advisers may attempt to avoid any potential liability now imposed under the fiduciary regime by only recommending lower cost and less risky securities to investors. After all, financial advisers and their employers may bear more

47. <http://www.fca.org.uk/firms/being-regulated/retail-investments/faqs> [accessed July 16, 2015]

48. A study commissioned by the Financial Conduct Authority, the regulatory body that developed RDR and enforces it, stated “The evidence currently available implies adviser charges have increased post-RDR, at least for some consumers,” and “Some firms are segmenting their client books and focusing on wealthier customers,” although the study found that this segmenting effect appears to have been relatively small to date. Europe Economics (2014) “Retail Distribution Review Post Implementation Review,” December 16, 2014, at 64 & 66. Similarly, see (stating that “Although the number of advisers has fallen, revenue from regulated businesses for financial advice firms has remained steady, at around £3.8 billion per annum, for the period from 2011 through to 2013.”) Association of Professional Financial Advisers (2014) “The Advice Market Post RDR Review,” June, at 4.

49. DOL Impact Analysis, at 173-4.

downside risk as a result of litigation (justified or unjustified) under the proposed regulatory change. This shift in the type of investment advice may further reduce investors' overall savings by lowering the returns earned on dollars saved because less risky securities tend to provide lower overall returns relative to more risky securities. For example, bonds provide lower expected returns than do equity.

39. Economic theory predicts that financial product providers who currently rely on load-sharing and other arrangements with advisers may also be affected. While the DOL speculates that these firms will “invest” to generate higher returns, these providers may not be able to generate higher returns and may be forced to spend additional funds in marketing to maintain their profitability. These other means may be equally or more costly than the current arrangements with advisers, and may raise other consumer protection issues.⁵⁰ In any case, those costs would likely be passed on, at least in part, to investors through higher fees.

40. Similarly, financial product providers that currently rely on load-sharing and other arrangements to sell their products may not be able to reach economies of scale using alternative distribution mechanisms, and as a consequence, may exit the market. If mutual funds or other financial product providers exit the market, IRA investors may not have as many choices, which could lead to suboptimal investment allocations.

41. Finally, academic literature on regulation also indicates that consumer-protection measures like the proposed amendments may lull consumers into a false sense of security by the

50. Available evidence indicates that mutual fund advertising is effective in driving fund flows, but does not signal superior fund performance. Prem C. Jain and Joanna Shuang Wu (2000) “Truth in Mutual Fund Advertising: Evidence on Future Performance and Fund Flows,” *Journal of Finance* 60(2):937-58. Hence, whatever gains investors experienced as a consequence of mitigating adviser conflicts of interest could be lost through the effects of increased advertising.

notion that government regulators are watching over them.⁵¹ As a consequence, they face incentives to be less careful, thus offsetting in full or in part whatever benefits the regulators may provide. In the context of the proposed amendments, investors may feel they do not need to be as careful with their retirement savings because the government is forcing their advisers to be more careful.

42. We do not hold a view that all of these costs are necessarily likely outcomes of the proposed amendments. Our discussion is only meant to highlight that regulations like the proposed amendments often create additional costs due to unintended consequences, and the DOL's estimates of costs have not substantively addressed the potential for such additional costs.

C. THE DOL'S COST ANALYSIS IS FLAWED IN OTHER WAYS THAT RENDER IT UNRELIABLE.

43. Even putting aside the failure to appropriately consider potential increased costs due to unintended consequences of the proposed amendments, the DOL's analysis of costs also suffers from other limitations that further render it unreliable. First, the DOL repeatedly relies upon unsupported assumptions. For instance, in analyzing the impact of the proposed amendments on advisers' insurance premiums, the DOL assumed a 10 percent increase due to advisers' new fiduciary status.⁵² No basis is provided for this critical assumption, even while available evidence indicates that fiduciary status in other contexts has had large effects on the likelihood of

51. See, similarly, W. Kip Viscusi (1984) "The Lulling Effect: The Impact of Child-Resistant Packaging on Aspirin and Analgesic Ingestions," *American Economic Review* 74(2):324-7.

52. DOL Impact Analysis, at 171.

litigation,⁵³ and litigation risk in the financial sector has been shown to have material impacts on insurance premiums.⁵⁴

44. The DOL also assumes without basis that rising insurance premiums are the only relevant litigation costs generated by the proposed amendments. The DOL ignores the full cost of litigation necessary to enforce regulations, including attorneys' fees (both plaintiffs' and defendants'), court costs, and opportunity costs for legal resources which otherwise could be employed in other types of cases.

45. While it may be appropriate to rely on assumptions in an economic analysis in certain cases, those assumptions must have at least some justification or basis in order for the analysis to be reliable. As a group of prominent economists stated in evincing principles of cost-benefit analysis, "Quantification of benefits and costs is useful, even where there are large uncertainties ... If the decision maker wishes to introduce a 'margin of safety' into his decision, he should do so explicitly. Assumptions should be stated clearly rather than hidden within the analysis."⁵⁵

46. Separately, the DOL's cost analysis also fails to consider the consequences of the proposed amendments for population subgroups. A careful cost-benefit analysis should analyze not only the total costs of the regulation at issue, but also who ultimately pays those costs, and whether such outcomes are equitable. As a prominent group of economists establishing principles for cost-benefit analysis of regulations stated, "A good benefit-cost analysis will identify important distributional consequences of a policy."⁵⁶

53. See, e.g., Erik J. Olson (2012) "Shareholder Class Litigation Arising from Mergers and Acquisitions," Association for Corporate Counsel ("Corporate directors are fiduciaries entrusted with the power and responsibility to supervise a corporation's business affairs and obligated to act in the best interests of the corporation and its shareholders ... With rare exceptions, shareholder plaintiffs base their claims on alleged violations of these fiduciary duties.")

54. John E. Core (2000) "The Directors' and Officers' Insurance Premium: An Outside Assessment of the Quality of Corporate Governance," *Journal of Law, Economics, & Organization* 16(2):449-77.

55. Arrow, et al. (1996) *op. cit.*, at 8.

56. Arrow, et al. (1996), *op. cit.*, at 6.

47. For instance, the DOL estimates direct costs to advisory firms and certain employees who may require additional licensure. But the DOL never considers the ultimate incidence of these costs and their implications for different groups of stakeholders or for social equity. As noted above, costs ostensibly imposed on firms will typically be passed on (at least in part) to consumers. Given the DOL's concerns regarding protection of vulnerable groups of investors, the consequences of such an outcome for specific groups of investors would seem highly important. It is very commonly the case that costs imposed by the government on one group are ultimately borne by other industry participants, and economists have developed standard approaches to estimating this "incidence" of government policy.⁵⁷ However, the DOL fails to apply these approaches.

IV. CONCLUSION

48. Though lengthy, the DOL's "Regulatory Impact Analysis" provides no reliable estimates of the costs and benefits of the proposed amendments, and as a consequence, does not justify the costs likely to be incurred by market participants (including IRA investors). Among other limitations in the DOL's benefits analysis, it improperly applies the results of the academic literature upon which it relies and, as a consequence, likely grossly overstates the benefits of the proposed amendments. The DOL's cost estimate is reminiscent of the old joke about the drunkard who looks for his lost keys under the streetlamp because that's where the light is. The DOL only attempts to quantify the most obvious and direct costs of the proposed amendments, while dismissing or overlooking a wide range of potential unintended consequences that could dramatically increase the costs. The history of regulation provides strong reason to be skeptical

57. See, e.g., Don Fullerton and Gilbert E. Metcalf (2002) "Tax Incidence," in *Handbook of Public Economics* 4:1787-1872.

of the DOL's assumption that the proposed amendments would have no costly unintended consequences.

APPENDIX

Compass Lexecon is an economic consulting firm that specializes in the application of economics to a variety of legal and regulatory issues. Compass Lexecon has a professional staff of more than 325 individuals and fourteen offices throughout the United States, Europe and South America. Compass Lexecon also maintains affiliations with leading academics including several Nobel Prize winners in Economics.

Lexecon, Compass Lexecon's predecessor firm, was founded in 1977 by, among others, then Professor (now Judge) Richard A. Posner of the Seventh Circuit Court of Appeals. Compass Lexecon was formed in January 2008 through the combination of Lexecon with Competition Policy Associates, another premier economic consulting firm. Compass Lexecon is a wholly owned subsidiary of FTI Consulting, Inc., a global business advisory firm. Professor Daniel R. Fischel currently serves as Compass Lexecon's Chairman and President.

Compass Lexecon's practice areas include antitrust, securities and financial markets, intellectual property, accounting, valuation and financial analysis, pension economics and policy, corporate governance, bankruptcy and financial distress, derivatives and structured finance, class certifications and employment matters, damages calculations, business consulting, regulatory investigations and public policy.

Compass Lexecon's clients include the United States Department of Justice and other agencies of the federal government, state and local governments, regulatory bodies, major corporations, investor groups, and leading law firms across the globe.

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APPENDIX 4

Comment on the Department of Labor Proposal and Regulatory Impact Analysis

July 17, 2015

EXECUTIVE SUMMARY

NERA Economic Consulting has been retained by SIFMA to review and comment on the U.S. Department of Labor's ("DOL") proposed conflict of interest rule and definition of the term "fiduciary" under ERISA (the "proposal"), and associated Regulatory Impact Analysis ("RIA"). The estimates in the above documents form the basis of the Department of Labor's argument that the proposed conflict of interest rule would provide a net "benefit" to the public.

To study these costs associated with the DOL proposal, NERA also collected account-level data from a number of financial institutions in order to construct a representative sample of retirement accounts. Our dataset includes tens of thousands of IRA accounts, observed over a period from 2012 through the first quarter of 2015.

Briefly, our findings are as follows:

- The DOL proposal may effectively make the commission-based brokerage model unworkable for investment accounts covered by ERISA due to the operational complexity and costs of compliance that would be required under the Best Interest Contract Exemption. Using our account-level data, we find that:
 - o Some commission-based accounts would become significantly more expensive when converted to a fee-based account under the DOL proposal.
 - o Investors can and do select the fee model (commission vs. fee) that best suits their own needs and trading behavior.
 - o A large number of accounts do not meet the minimum account balance to qualify for an advisory account.

- o There is no evidence that commission-based accounts underperform fee-based accounts.
- In 2011, the DOL estimated that consumers who invest without professional advice make investment errors that collectively cost them \$114 billion per year. Applying the DOL's own logic to the present proposal, combined with the likelihood that a large number of investors will lose access to advice, will result in aggregate costs that may exceed the DOL's own estimates of the benefits of the proposal.
- The RIA produces many different numbers representing different underlying assumptions, resulting in industry cost estimates that vary wildly from about \$2 bil./year to \$50 bil./year. The range of numbers is so wide it suggests no scientific confidence in their own methodology.
- The academic research cited in the RIA is misapplied.
 - o While the academic literature focuses on mutual funds, it is applied more widely to other assets such as variable annuities in order to come up with the asset base of \$1.7 trillion in retirement assets.
 - o The most frequently cited paper in the RIA takes results from a statistical analysis on certain types of funds and misapplies those results to all funds. This likely exaggerates the importance of the findings cited by the DOL.
 - o The academic literature cited in the RIA does not compare the costs and benefits of fiduciary accounts with those of brokerage accounts. Therefore, any findings based on this research are inappropriate as a basis for the DOL proposal.
- Overall the DOL's misapplied use of the academic literature and erroneous conclusions on investor behaviors render their regulatory impact analysis unreliable and incomplete.

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I. COSTS OF IMPEDING THE COMMISSION-BASED INVESTMENT MODEL

The Department of Labor’s (“DOL”) proposed conflict of interest rule and definition of the term “fiduciary” under ERISA (the “proposal”), and associated Regulatory Impact Analysis (“RIA”)^{1,2} have led many to conclude that the proposal would effectively make the commission-based brokerage model unworkable for investment accounts covered by ERISA and similar sections of the IRS code due to the operational complexity and costs of compliance that would be required under the Best Interest Contract exemption. In this section, we use account-level data to pursue the question of how this result would affect existing holders of commission-based accounts.

There are at least two immediate consequences to the proposed rule change. The first is that some commission-based accounts would become more expensive, in the sense that average fees would increase, particularly for investors who trade infrequently. Second, advisory or “fee-based” accounts currently have minimum balance requirements. These account balance requirements are in place to ensure that the firm serving the client can at least break even on the operating costs associated with administering advisory accounts. Using account-level data, we can estimate the percentage of consumers currently in commission-based accounts who would not meet the minimum account balance requirements and therefore lose access to professional investment advice under the DOL proposal.

We begin with a discussion and summary of the account-level data that NERA has collected for this study.

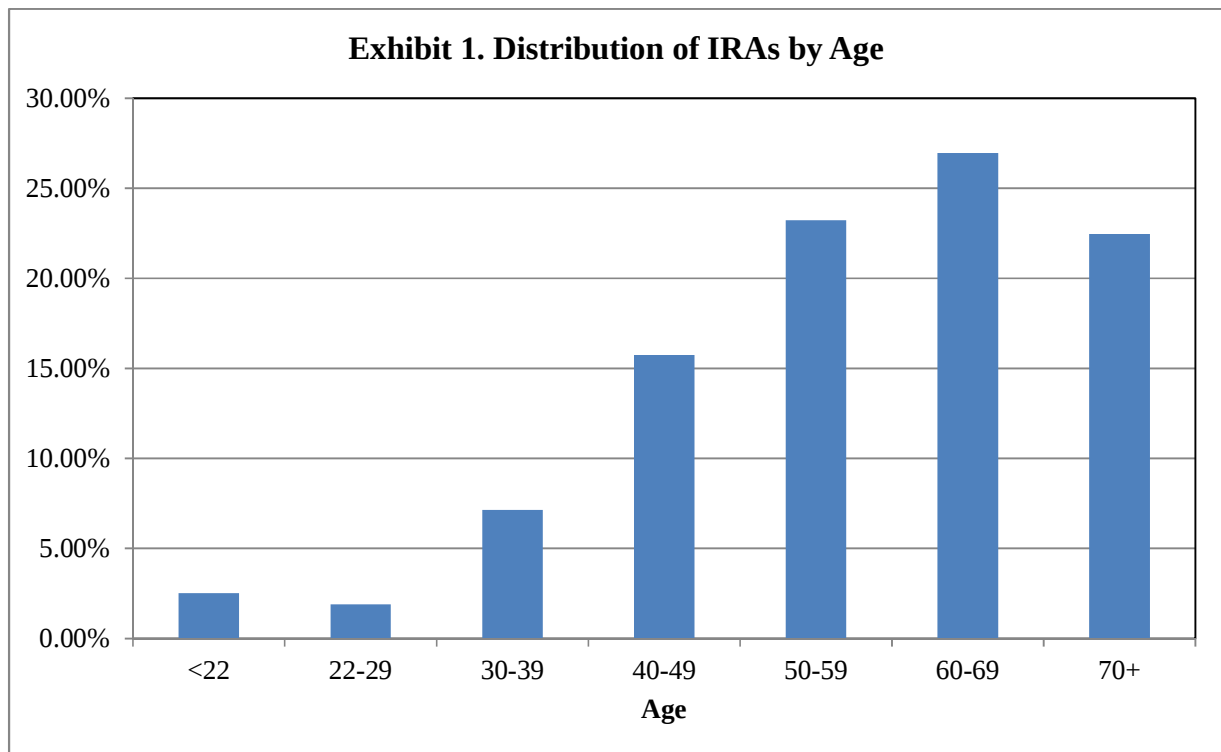
A. Summary of Data

The RIA itself recognizes (p. 101) “the absence of comprehensive data” with which to conduct a complete analysis of the proposal. To address that void, we collected account-level

¹ 29 CFR 2509 and 2510, DOL, Definition of the Term “Fiduciary”; Conflict of Interest Rule-- Retirement Investment Advice; Proposed Rule in Federal Register Volume 80, Number 75 (Monday, April 20, 2015), Pages 21927-21960.

² “Fiduciary Investment Advice Regulatory Impact Analysis”, Department of Labor, Available on-line at www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf.

data from a number of financial institutions in order to construct a representative sample of retirement accounts. Our dataset includes over 63,000 IRA accounts, with data ranging from 2012 through the first quarter of 2015. The investors in our dataset are distributed across a wide range of age groups, with the bulk of IRAs held by investors aged 50 or older, as shown in Exhibit 1.

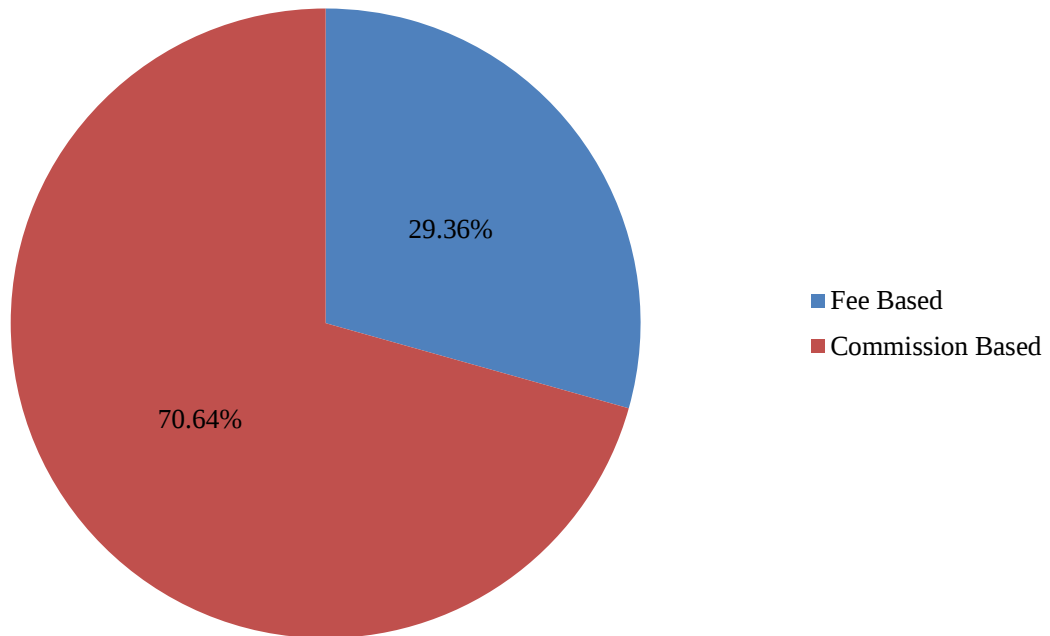


The data we collected from the participating firms contains various types of account-level data fields, including: balances, fees, activity, and positions. In order to conduct an analysis, we merged the data from the various firms into one combined dataset.

Fees

Based on data received from participating firms, we classify IRAs into two broad fee-type categories: fee-based and commission-based accounts. Fee-based accounts are charged a fixed fee as a percentage of assets whereas commission-based accounts are charged fees based on trading and other activity. As shown in Exhibit 2, approximately 70.6 percent of our accounts are commission-based; the rest are fee-based.

Exhibit 2. IRA Account Structure



Fees include all proceeds paid by the account-holder directly to the firm, such as management fees and trading commissions.³ They exclude, however, fees paid to third-parties such as mutual fund managers.

The median account balance in our sample is \$57,072, with the 25th and 75th percentiles falling at \$17,511 and \$166,794 respectively.⁴ These summary statistics are shown in Table 1 below.

³ Fees exclude revenue that the firm may receive indirectly from the account-holder, such as markup/markdown revenue or 12b-1 fees. Recognizing that such indirect revenues are not included in our fee data, we construct returns which are net of *all* fees, both direct and indirect. These net returns are presented in section I.E.

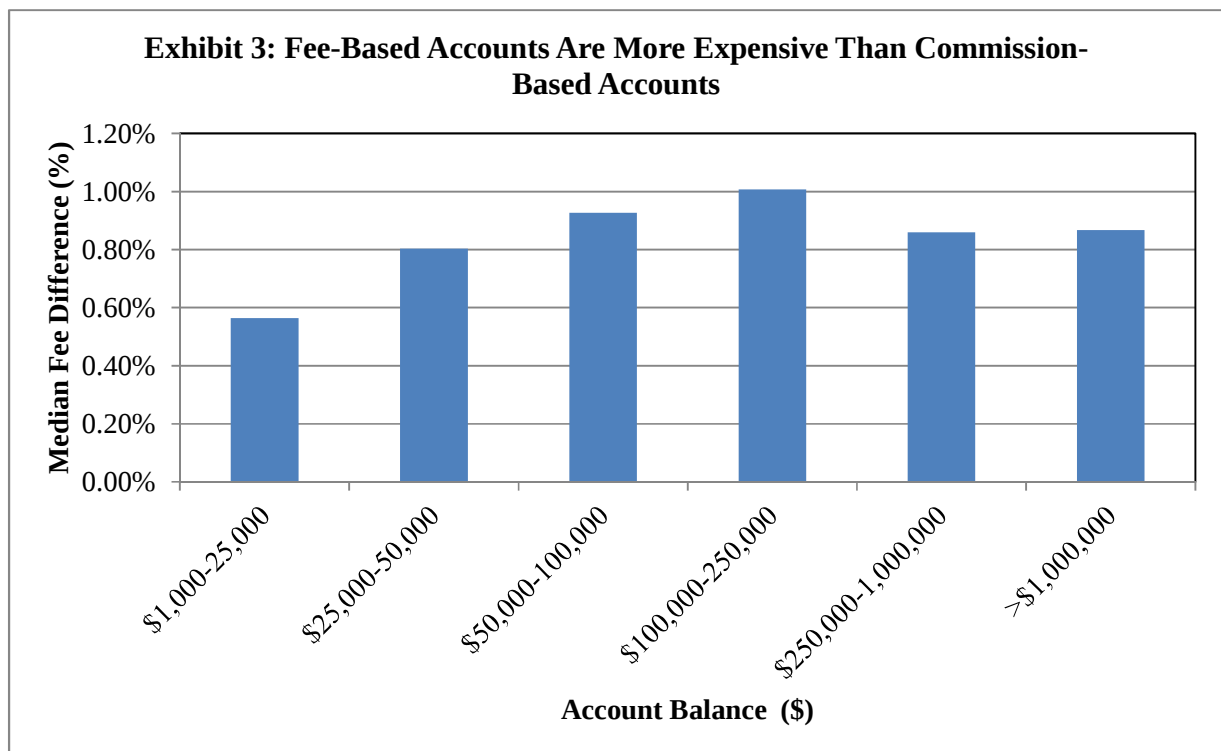
⁴ In our analyses, we exclude accounts with balances below \$1,000.

Table 1. Account Balances

	<u>Account Balance (\$)</u>
Mean	174,034
Median	57,072
25th Percentile	17,511
75th Percentile	166,794

B. Some Accounts Would Become More Expensive under the DOL Proposal

Our account-level dataset allows us to identify a large number of accounts as having a fee structure which is either fee-based, or commission-based. In Exhibit 3, we present the difference between median fee-based and commission-based account fees, as a percentage of account balance, for various levels of account balance. The chart shows that this difference is always greater than zero; in other words, holders of fee-based accounts pay higher fees, in percentage terms, for all levels of account balance.



The differences tend to be in the range of about 57 basis points (bps) for relatively small accounts (those with balances below \$25,000) up to about 1 percent for accounts with balances from \$100,000 to \$250,000. This suggests that investors would pay more if moved to fee-based accounts. Indeed, the magnitude of the increased cost is on par with the 1 percent “cost of conflicted advice” claimed in the White House/CEA memo that preceded the DOL proposal. The numerical results are reported in Table 2, below.

Table 2. Fees by Balance and Account Type

Balance Range	Median		Difference
	Fee Based	Commission Based	
\$1,000-25,000	1.24%	0.67%	0.57%
\$25,000-50,000	1.16%	0.36%	0.80%
\$50,000-100,000	1.20%	0.27%	0.93%
\$100,000-250,000	1.25%	0.24%	1.01%
\$250,000-1,000,000	1.09%	0.22%	0.86%
Greater than \$1,000,000	0.99%	0.12%	0.87%

C. Account-Level Data Suggests that Investors Select the Fee Model that Best Suits Their Own Needs and Trading Behavior

In the data, one of the most striking behavioral distinctions between fee-based and commission-based accounts is that the former tend to trade more frequently. We also calculated investors’ aggregate trading activity by looking at both the number and dollar amount of purchases and sales in each account.⁵ We measure trading activity in two ways: number of trades and account turnover. Number of trades counts each discrete purchase and sale during the time period. Account turnover takes the minimum of the total dollar amount purchased and the total dollar amount sold as a percentage of the average dollar balance during the year. Summary statistics of trading activity are presented below in Table 3.

⁵ Where we could not break out dividends from new investments, trades may include dividend reinvestments.

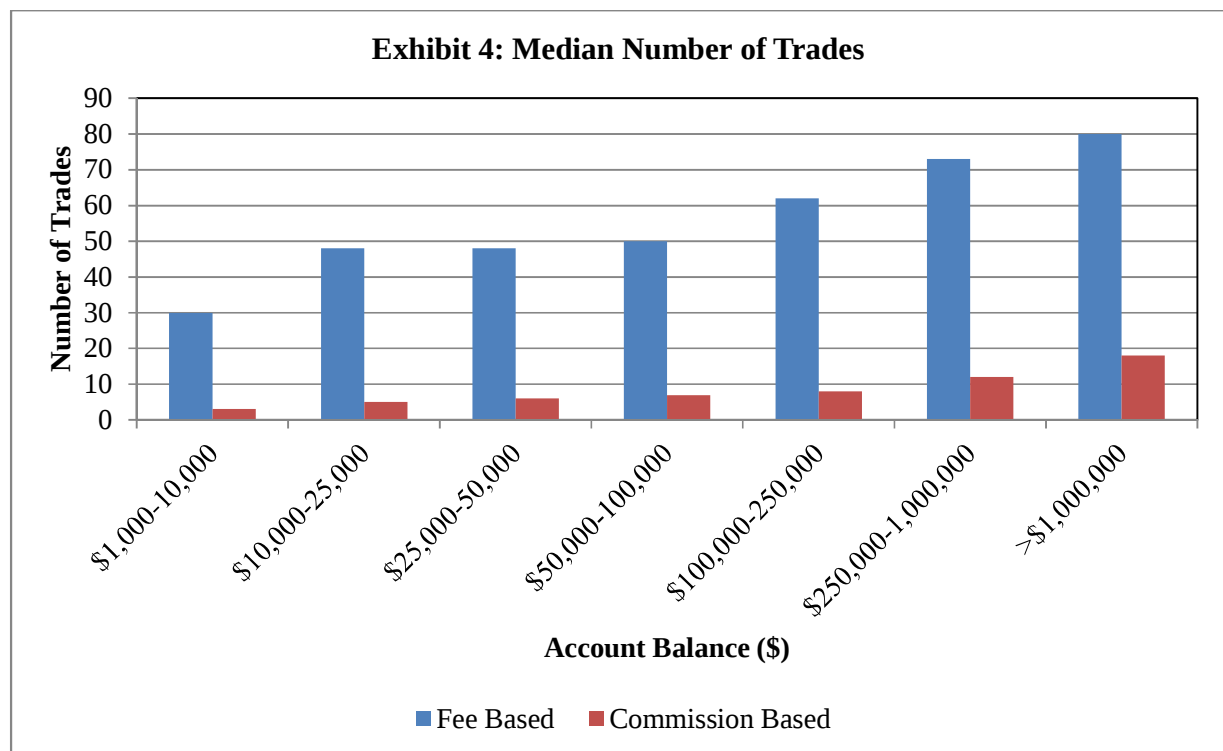
Table 3. Trading Activity

	Number of Trades	Account Turnover
Mean	54	34.11%
Median	16	14.79%
25th Percentile	4	4.84%
75th Percentile	56	39.31%

Exhibit 4 below shows the number of trades, or transaction frequency, of fee-based and commission-based accounts in 2014 for various account balance levels.

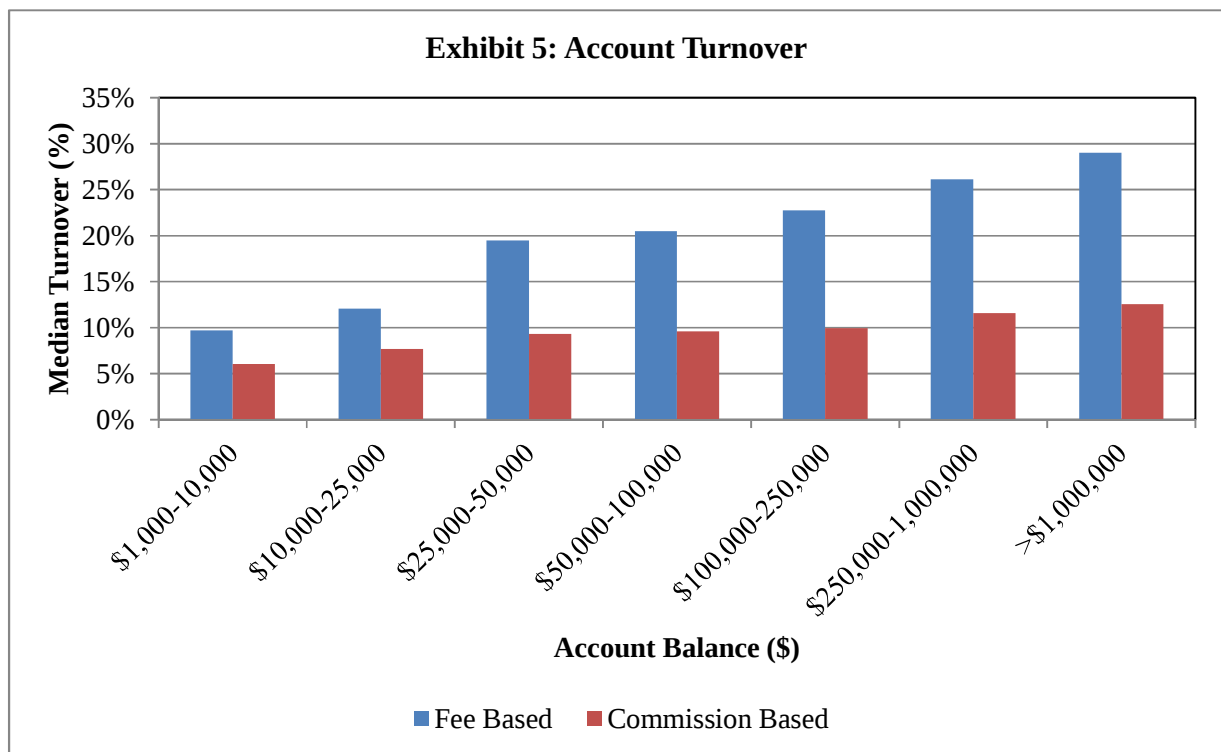
In 2014, the median trade frequency in commission-based accounts was just 6 trades. By comparison, in fee-based accounts the median trade frequency was 57 trades, with larger accounts generally trading more frequently than smaller ones.

Thus, the data are consistent with the idea that investors who expect to trade often rationally choose fee-based accounts whereas those that do not trade often are likely to choose commission-based accounts.



Additionally, it is worth noting that the data does not seem to show “churning,” the needless buying and selling of securities. We see the median commission-based account had traded 6 times in 2014. Such trading is more consistent with a buy-and-hold strategy than churning.

The interpretation of the account-level data as being consistent with investors who trade infrequently self-selecting into commission-based accounts is further supported by account turnover. The median dollar-value of transactions, as a fraction of account balance, is show in Exhibit 5 below, for various levels of account balance.



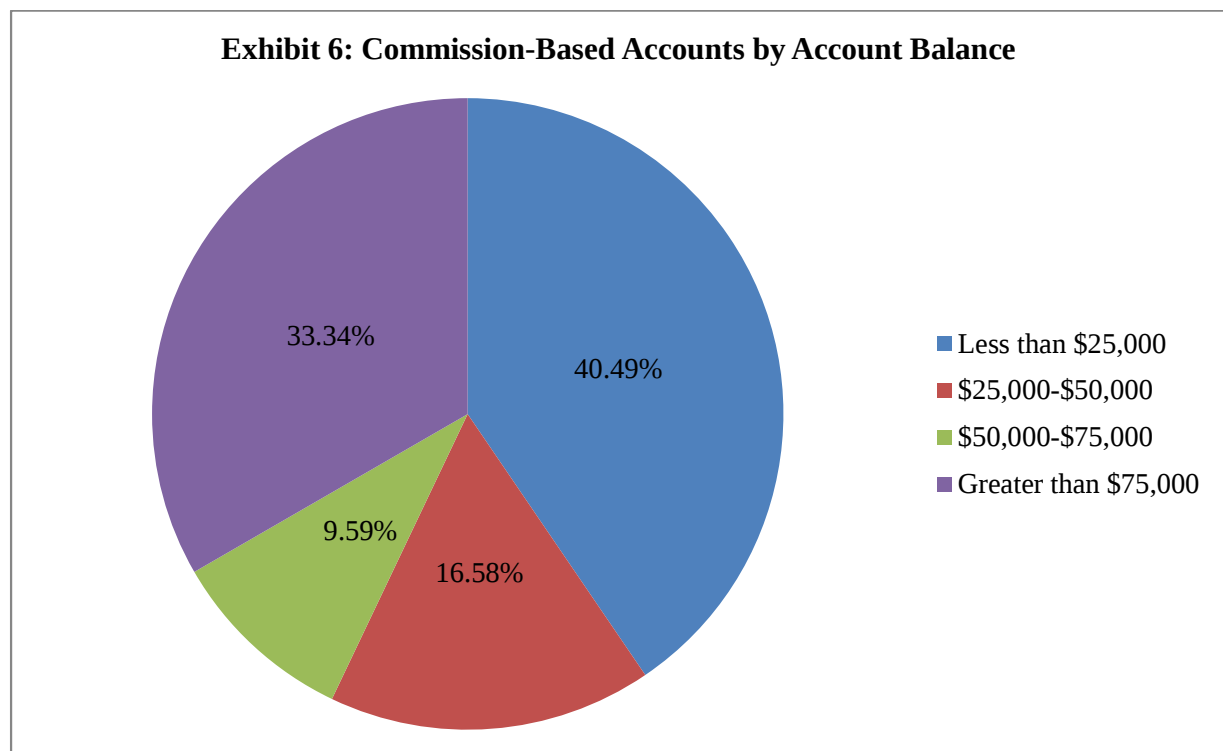
The median commission-based account across all balances only turns over 8.9 percent of its assets annually. For fee-based accounts the median turnover is 22.1 percent.

D. Some Account Balances Are Too Small for RIA Accounts

As mentioned above, a primary concern with the DOL proposal is that it would make commission-based accounts unworkable. If this turns out to be the case, investors will have to move to fee-based accounts or lose access to professional investment advice entirely.

Using our account-level data, we can estimate the number of investors who currently have commission-based accounts with balances below the minimum required account balance for advisory accounts.⁶

The results are shown in Exhibit 6. Using the conservative minimum account balance of \$25,000, over 40% of commission-based accounts in our dataset would not be able to open fee-based accounts. Using a \$50,000 threshold, over 57% of accounts would not meet minimum balance requirements for a fee-based account. If the effective threshold is \$75,000, two-thirds of account holders would be left without any professional investment advice.



⁶ An important limitation in our data is that we have collected account-level data, which may not coincide with household-level data. We may therefore be understating the ability of some households to combine separate IRA accounts held within the same household to achieve the minimum balance requirement. This limitation also likely explains the existence of fee-based accounts smaller than \$10,000 in our dataset.

E. Commission-Based Accounts Do Not Underperform

We calculate returns on a quarterly basis by calculating the change in account balance, adjusting for net flows during the quarter.⁷ Since fees are deducted from account balances, either directly or indirectly, returns calculated based on account balances are net of fees.

We find that the median annualized return across all accounts in our sample, over the period from June 30, 2012 to March 31, 2015, is 10.3 percent.

In terms of differential fee structures, if investors in commission-based account are subject to the “cost of conflicted advice”, then we would expect to see an underperformance in terms of the returns they earn. Indeed, this is explicitly the argument made in the DOL proposal.

Over the time periods for which we have data, commission-based and fee-based accounts exhibit similar performance, when calculated net of fees. The median differences in returns are shown, quarter by quarter, in Table 4. As the data show, the difference in return is sometimes positive and sometimes negative but small in magnitude. Moreover, the difference in returns is not statistically significant.

Table 4. Fee-Based Returns Less Commission-Based Returns

Date Range	Difference in Median Quarterly Return
06/30/12-09/30/12	-0.14%
09/30/12-12/31/12	0.63%
12/31/12-03/31/13	-1.96%
03/31/13-06/30/13	-0.91%
06/30/13-09/30/13	0.62%
09/30/13-12/31/13	-0.08%
12/31/13-03/31/14	-0.44%
03/31/14-06/30/14	-0.18%
06/30/14-09/30/14	-1.04%
09/30/14-12/31/14	0.04%
12/31/14-03/31/15	0.33%
Average	-0.28%

⁷ Net flows include cash and other transfers to and from the account that are not investment-related (i.e.: withdrawals and contributions). Net flows were constructed to exclude fees, dividends, and interest, to the extent it was possible to identify these payments in the underlying transaction data. To eliminate the potential impact of outliers on our findings, we removed the top and bottom 1 percent of returns from our calculations (where such outliers may reflect the timing of transactions in our data, and not be reflective of actual returns).

Overall, from June 30, 2012 to March 31, 2015, the average difference (where again the difference is the fee-based return minus the commission-based return) is -0.28 percent. Thus, there is no support in this data for the contention that commission-based accounts underperform.⁸ An alternative interpretation of the finding that returns are roughly equal across the two fee structures is that investors self-select into account types that are appropriate for them and that this leads to equilibrium.

II. COST OF LOSING ACCESS TO ADVICE

In order to conduct a proper cost-benefit analysis, it is important to consider all of the costs associated the proposed rule. Indeed, the DOL Regulatory Impact Analysis itself states (p.99-100) that:

“A full accounting of a rule’s social welfare effects would encompass all of the rule’s direct and indirect effects as would be manifest in general market equilibrium. Likewise, that full accounting would consider pure social welfare costs – that is, reductions in economic efficiency – which are not the same as simple compliance costs.”

The RIA goes on to recognize that (p. 100): *“The quantitative focus of this analysis, however, is on the proposal’s most direct, and directly targeted, effects: gains to retirement investors, and compliance costs to advisers and others.”*

But the DOL fails to measure one important cost—the cost of the loss of advice to investors. In this section we partly address this shortcoming by explicitly considering the costs that would be incurred by those consumers who completely lose access to professional investment advice as a result of the DOL proposal.

In prior studies, the DOL itself acknowledged this cost. An October 2011 DOL cost-benefit analysis published in the Federal Register on the “final rule” relating to the provision of investment advice under ERISA included estimates of the costs to consumers of not having access to advice.⁹ In that document, the DOL estimated that participant-directed retirement

⁸ The sign of the difference might be read to mean that commission-based accounts outperform fee-based accounts in our dataset, but in fact the difference is not statistically different than zero in any of the quarters in our sample period.

⁹ 29 CFR 2550, DOL, Investment Advice – Participants and Beneficiaries, Final Rule, October 2011.

savings account holders make investment mistakes in the absence of professional advice valued at an aggregate of “more than \$114 billion in 2010” (p.66151).

Moreover, the 2011 DOL cost-benefit analysis estimated the effects of a change in public policy on investors’ access to professional investment advice. In particular, the DOL estimated that the enactment of the Pension Protection Act of 2006 (P.L. 109-280, the “PPA”) increased access to advice, and hence reduced aggregate investing errors by \$7 billion to \$18 billion per year. These are extremely large numbers, and hence clearly indicate the DOL’s own estimation of the importance to investors of access to professional advice.

A. Estimates of Number of Investors Who Will Lose Access to Advice

As discussed in section I.A above, our account-level data allows us to identify a large number of accounts as having a fee structure which is either fee-based, or commission-based, by account balance. For example, we noted above that 40.49 percent of the accounts that are currently commission-based have balances below \$25,000 in our sample.

If the DOL proposal were to make commission-based accounts unworkable for broker-dealers, these accounts could no longer be maintained. Moreover, many commission-based accounts have small balances and so would be below the minimum account balance for advisory accounts. These investors will be left on their own with no access to professional investment advice.

If we were to take at face value the DOL’s methodology in the 2011 cost-benefit analysis discussed above, and assume a minimum-balance threshold of \$25,000, the new fiduciary standard would cause a loss of access to professional advice for 40.49 percent of commission-based retirement account holders. It would take a relatively small number of such accounts to lose advice for this to result in an aggregate cost that exceeds the \$17 billion in purported benefits claimed in the White House/CEA memo.

Moreover, this is based on a conservative estimate of the minimum balance, at only \$25,000. Even at this level, the aggregate cost could easily be on par with the DOL’s own estimates of the “cost of conflicted advice”.

Hence, using the DOL’s own approach, the costs of the proposal likely exceed its benefits once we account for other costs such as the cost of compliance.

B. Implications of Losing Access to Advice: Individual Investors Make Systematic Errors When Investing on Their Own

In this section we first review the extensive academic and professional literature on the value to investors of having access to professional investment advice. The discussion begins with a survey of the potential pitfalls faced by many individuals who invest on their own. We then discuss the established literature that documents ways in which the use of professional advisors tends to lead to fewer such investment errors.

Additionally, it is worth noting that below, in section III.D, we discuss an earlier 2011 cost-benefit analysis on the Pension Protection Act of 2006 in which the DOL itself recognized the implications of investors losing access to professional investment advice. The conclusions of that DOL study are similar to the academic findings discussed in this section.

1. The disposition effect and mental heuristics

Ever since the seminal work of Kahneman and Tversky (1979, 1992), it has been widely accepted that individual investors are prone to making systematic mistakes in the way they evaluate and treat investment decisions in the presence of uncertainty.¹⁰ Indeed, Kahneman was awarded the Nobel Prize in Economics for this work in 2002. This research agenda was typically accompanied by experimental data, but not backed up with actual accounts and transactions of individual investors.

In the 1990's, however, Odean (1998) built upon the earlier literature by analyzing the trading records of ten thousand accounts at a large nationwide discount brokerage firm. The dataset he collected covered the period 1987 through 1993.¹¹ The data includes an account identifier, trade dates, the security traded, a buy-sell indicator, the quantity traded, the commission paid and the principle amount. The study compared the selling price for each stock sold to its average price to determine whether that stock is sold for a gain or loss. One of the primary findings of the paper was that investors demonstrate a strong preference for realizing winners rather than losers. This phenomenon is now widely known as the “disposition effect” for individual investors.

¹⁰ Kahneman, D and A. Tversky (1979), “Prospect Theory: An Analysis of Decision under Risk,” *Econometrica* **47** (2): 263 and Tversky, A and D. Kahneman (1992), “Advances in prospect theory: cumulative representation of uncertainty,” *Journal of Risk and Uncertainty* **5** (4): 297–323.

¹¹ Odean, T. (1998), “Are Investors Reluctant to Realize Their Losses?” *Journal of Finance*, 53, 1775-1798.

Since Odean (1998), the disposition effect has been confirmed by numerous studies. Goetzmann and Massa (2004) construct a variable based on investor trades that acts as a proxy for the representation of disposition-prone investors in the market and test how it relates to stock returns.¹² The authors report a strong negative correlation between the disposition effect and stock returns. Grinblatt and Han (2005) also study the disposition effect, and in particular the tendency of investors to hold on to their losing stocks.¹³ They attribute this behavior to prospect theory, or the tendency to under weigh outcomes that are merely probable in comparison to outcomes that are obtained with certainty, and to a psychological phenomenon known as “mental accounting”. The authors find that the tendency for households to fully sell winning stocks is weaker for wealthy investors with diversified portfolios of individual stocks.

Franzini (2006) uses a database of mutual funds holdings to construct a measure of reference prices for individual stock and confirms the existence of the disposition effect.¹⁴ Moreover, the author suggests that the disposition effect can induce under-reaction by individual investors to news, leading to return predictability and post-announcement price drift. In particular, bad news travels slowly among stocks trading at large capital losses, in turn leading to a negative price drift, and good news travels slowly among stocks trading at large capital gains.

Nor is this literature limited to academic circles. The Morgan Stanley Consulting Group (2014), for example, studied the various behavior biases that can impair the performance of individual investors in managing their own portfolios.¹⁵ The authors point to “psychological blindspots” that negatively influence investors such as overconfidence, mental accounting, anchoring biases, framing biases and loss aversion. Their research suggests that a financial advisor can mitigate the effects of these problems because they have a clearer understanding of the investment process.

2. Mental heuristics disproportionately affect people with fewer savings

As argued above, the academic literature has documented evidence that individual investors display irrational and costly investing behavior in the form of the disposition effect.

¹² Goetzmann, W. and M. Massa (2004), “Disposition Matters: Volume, Volatility and Price Impact of Behavioural Bias,” *Centre for Economic Policy Research*, Paper No. 4814.

¹³ Grinblatt, Mark and Bing Han (2005), “*Prospect theory, mental accounting and momentum*,” *Journal of Financial Economics*, 78, 311-339.

¹⁴ Frazini, Andrea (2006), “The Disposition Effect and Underreaction to News,” *The Journal of Finance*, 61, No. 4

¹⁵ Morgan Stanley Consulting Group, “The Value of Advice,” (2014), available on-line at www.morganstanleyfa.com/public/projectfiles/thevalueofadvice.pdf

Beyond this general observation, there is also a strand of research that shows that these flaws tend to disproportionately affect people with lower levels of wealth.

Grinblatt and Keloharju (2000) employ the central register of shareholdings for Finnish stocks in the Finnish Central Securities Depository (FCSD), a comprehensive data source which covers 97 percent of the total market capitalization of Finnish stocks beginning in 1995.¹⁶ The data set reports institutional holdings and stock trades on a daily basis. The authors find that generally the more sophisticated the investor and the greater the wealth invested in stocks, the less contrarian (buying losing stock and selling winning stock) is the investment strategy. The degree of contrarianism appears to be inversely related to a ranking of the sophistication of investor types.

Dhar and Zhu (2002) analyze the trading records of a major discount brokerage house and confirm the existence of the disposition effect.¹⁷ The paper finds empirical evidence that wealthier and individual investors in professional occupations exhibit less disposition effect. Trading experience also tends to reduce the disposition effect.

Calver, Campbell and Sodini (2009) study a dataset containing the disaggregated wealth of all households in Sweden between 1999 and 2002. The authors find that contrary to rational expectations, households are more likely to fully sell directly held stocks if those stocks have performed well and more likely to exit direct stockholding if their stock portfolios have performed well.¹⁸ This paper examines changes in household behavior over time, specifically decisions to scale up or down the share of risky assets in the total portfolio, to enter or exit risky financial markets, to full sell individual risky assets and to scale up or down the share of individual assets in the risky portfolio. By doing so, the authors develop an adjustment model with different target risky shares across households. The authors find that wealthy, educated investors with better diversified portfolios tend to rebalance more actively. Specifically, the authors point to wealth and portfolio diversification as more relevant than income in predicting the strength of the disposition effect

¹⁶ Grinblatt, Mark and Matti Keloharju (2000), "The investment behavior and performance of various investor types: a study of Finland's unique data set" *Journal of Financial Economics*, 55, 43-67.

¹⁷ Dhar, Ravi and Ning Zhu (2002), "Up Close and Personal: An Individual Level Analysis of the Disposition Effect," *Yale ICF Working Paper No. 02-20*.

¹⁸ Calver, Laurent E. and John Y. Campbell and Paolo Sodini (2009), "Fight or Flight?" *The Quarterly Journal of Economics*, 124, 1.

Cerqueira Leal, Rocha Armada and Duque (2010) use a database of 1,496 trading records of individual investors in the Portuguese stock market from January 1, 1999 to December 31, 2002, consisting of initial position, account movements, events and daily closing stock prices.¹⁹ The authors then calculate the “proportions of gains realized and the proportions of losses realized” based on each investor’s portfolio for each day of the sampling period. The authors find that less sophisticated investors (defined by average account value, number of shares traded and number of trades) exhibit a stronger disposition effect.

3. Individual investors churn

Aside from the disposition effect described above, another well-known error that is commonly observed in un-advised, self-directed, individual investors is the tendency to trade too often, or “churn”. In a seminal paper, Barber and Odean (2000), analyze the returns earned on common stock investment by 66,465 self-directed households. The net return earned by these households underperforms a value-weighted market index by about 9 basis points per month (or 1.1 percent annually).²⁰ Those that trade the most earn an annual return rate of 11.4 percent, while the market returns 17.9 percent. The poor performance of the average household can be traced to the costs associated with this high level of trading. The authors find a negative correlation between trading frequency and investment returns.

Similarly, Barber, Lee, Liu and Odean (2007) use a complete trading history of all investors in Taiwan, and document that the aggregate portfolio of individual investors suffers an annual penalty of 3.8 percentage points.²¹ These losses virtually all come from aggressive trading. In contrast, institutional investors enjoy an annual performance boost of 1.5 percentage points--even after commission and transaction taxes. Foreign institutional investors garner nearly half of the institutional profits. The author points out that investors who are saving to meet long term goals would benefit from effective guidance regarding best investment practices.

¹⁹ Cerqueira Leal, Cristiana and Manuel J. Rocha Armada, and Joao C. Duque (2010), “Are All Individual Investors Equally Prone to the Disposition Effect All The Time? New Evidence from a Small Market,” *Frontiers in Finance and Economics*, 7, No. 2, 38-68.

²⁰ Barber, M. Brad and Terrance Odean (2000), “Trading is Hazardous to Your Wealth: The Common Stock Investment Performance of Individual Investors” *The Journal of Finance*, 60, No. 2.

²¹ Barber, Brad M., Yi-Tsung Lee, Yu-Jane Liu, and Terrance Odean (2007) “Just How Much Do Individual Investors Lose by Trading?” *AFA 2006 Boston Meetings Paper*.

C. Benefits of Financial Advisors

Having established that individual investors are prone to making systematic mistakes in their investing due to behavioral biases, it is natural to ask whether such errors are reduced, on average, by having access to professional advice. The answer, unsurprisingly, tends to be “yes” in the by extensive academic and professional literature.

1. Portfolio allocations that are more diversified and closer to model portfolios

Bluethgen, Gintschel, Hackethal and Mueller (2008) examine a dataset of 12,000 German bank accounts, categorizing bank customers as “advised customers” or “self-directed”, and find that financial advice enhances portfolio diversification, and makes investor portfolios more congruent with predefined model portfolios.²² While the bank in the study derived more revenues from advised clients, the advised clients’ portfolios also resembled more closely the optimal portfolios prescribed by financial theory. The authors conclude that financial advisory service has a “significant impact on household investment behavior.”

Gerhardt and Hackethal (2009) collect a data set on 65,000 private investors and analyzed the portfolio composition and trading behavior of more than 14,000 persons and note that there are clearly positive effects to working with an advisor.²³ These benefits include: less speculative trading and a more diversified portfolio.

A study commissioned by the Investment Funds Institute of Canada (2010) analyzed a longitudinal database with Canadian households’ financial behaviors and attitudes.²⁴ The study isolated 3200 households and broke the sample into two groups – those who had an advisor in both years and those who did not have an advisor in either year. The authors found that households that received investment advice had substantially higher investable assets than non-advised households, controlling for age and income level. Additionally, investors without advice save less, utilize tax-advantaged savings opportunities less, and invest in securities with less opportunity for future investment growth than their advised counterparts.

²² Bluethgen, Ralph, Andreas Gintschel, Andreas Hackethal, and Armin Mueller (2008), “Financial Advice and Individual Investors’ Portfolios.”

²³ Gerhardt, Ralf and Andreas Hackethal (2009), “The Influence of Financial Advisors on Household portfolios: A study on Private Investors switching to Financial Advice,” February 14, 2009.

²⁴ The Investment Funds Institute of Canada (2010), “The Value of Advice Report,” available on-line at www.ific.ca/wp-content/uploads/2010/07/IFIC-Value-of-Advice-Report-2010-July-2010.pdf/4001/

A paper by the Investment Funds Institute of Canada (2012) stresses the importance of the CIRANO 2012 research, as well as citing papers from Australia and the United States.²⁵ Summarizing the existing literature, the paper notes that research proves that advice has a positive and significant impact on wealth accumulation, leads to better long term investment strategies and benefits the wider macroeconomy.

Kramer (2012) compares portfolios of advised and self-directed Dutch individual investors to investigate whether financial advisers add value to individual investors' portfolios.²⁶ The author finds that advised portfolios are more diversified and perform better than self-directed portfolios, thus reducing avoidable risk. The author (at least partly) attributes the reduction of idiosyncratic risk observed in advised portfolios to advisory intervention

In a widely-cited paper, Kinniry, Jaconetti, DiJoseph and Zilbering (2014), argue that through suitable asset allocation using broadly diversified funds/ETFs, cost effective implementation, rebalancing, behavioral coaching, asset location, spending strategy, and total-return versus income investing strategies, advisors can potentially add about 3 percent in net returns to investors.²⁷ For some investors, the value of working with an advisor is peace of mind. The value of an advisor for investors "without the time, willingness, or ability to confidently handle their financial matters" should not be ignored by "the inability to objectively quantify it." The authors argue that value added cannot be analyzed as an annual figure because "the most significant opportunities to add value occur during periods of market duress or euphoria when clients are tempted to abandon their well-thought-out investment plan."

Mardsen, Zick and Mayer (2011) argue that working with an advisor is related to several important financial planning activities including goal setting, calculation of retirement needs, retirement account diversification, use of supplemental retirement accounts, accumulation of emergency funds, positive behavioral responses to the recent economic crisis and retirement confidence.²⁸

²⁵ The Investment Funds Institute of Canada (2012), "The Value of Advice Report," available on-line at www.ific.ca/wp-content/uploads/2013/02/IFIC-Value-of-Advice-Report-2012.pdf/1650 /

²⁶ Kramer, Marc M. (2012), "Financial Advice and Individual Investor Portfolio Performance," *Financial Management*, 41, No. 2, 395-428.

²⁷ Kinniry, Francis M., Jr., Colleen M. Jaconetti, Michael A. DiJoseph, and Yan Zilbering (2014), "Putting a value on your value: Quantifying Vanguard advisor's Alpha," *The Vanguard Group*.

²⁸ Mardsen, Mitchell, Cathleen D. Zick, and Robert N. Mayer (2011), "The Value of Seeking Financial Advice," *Journal of Family and Economic Issues*, 32, No. 4, 625-643.

Winchester, Huston and Finke (2011) collect data containing 3,022 respondents with at least \$50,000 in annual income.²⁹ These individuals also had equity holdings that they could control or direct during market downturns. The authors used “investor prudence” as the dependent variable and noted whether the individuals rebalanced their portfolio over a market decline. The authors find that investors who use a financial advisor are about one-and-a-half times more likely to adhere to long-term investment decisions. Moreover, investors with a written financial plan are almost twice as likely to make optimal long term financial decisions.

2. Advisors help investors stop making investing mistakes

Shapira and Venezia (2001) argue that professionally-managed accounts experienced better roundtrip performance than those administered independently.³⁰ The authors find that the disposition effect, or the tendency of investors to sell shares whose price has increased, while keeping assets that have dropped in value, is significantly weaker for professional investors. This indicates that professional training and experience reduces judgmental biases, even though it cannot eliminate them. The authors point to this as an advantage in enlisting professional advice.

Maymin and Fisher (2011) used data from a boutique investment management firm, Gertstein Fisher.³¹ The data includes all account and household information, client introduction history, notes, and portfolio allocations and performances since 1993. The authors test five predictions by analyzing the contacts actually recorded between clients and the manager in the data set. The authors conclude that the advisor’s role in helping investors stay disciplined and on plan in the face of market volatility, including dissuading them from excessive trading, is one that is highly valued by the individual investor.

3. Tax minimization

Horn, Meyer and Hackethal (2009) use transaction data from a German bank from 1999-2008, to study a natural experiment of the introduction of a withholding tax in Germany in order to see how private investors react to changes in taxation.³² The authors conclude that financial

²⁹ Winchester, Danielle D., Sandra J. Huston, and Michael S. Finke (2011), “Investor Prudence and the Role of Financial Advice,” *Journal of Financial Service*, 65, No. 4, 43-51.

³⁰ Shapira, Zur and Itzhak Venezia (2001). *Patterns of Behavior of Professionally Managed and Independent Investors*, *Journal of Banking and Finance*, 25, No. 8, 1573-587.

³¹ Maymin, Philip Z. and Gregg S. Fisher (2011), “Preventing Emotional Investing: An Added Value of an Investment Advisor.” *The Journal of Wealth Management*, 13, No. 4.

³² Horn, Lutz, Steffen Meyer and Andreas Hackethal (2009), “Smart Investing and the Role of Financial Advice – Evidence from a natural Experiment Using Data Around a Tax Law Change,” Working Paper Series.

advisors help people make smarter investment decisions because of their financial sophistication and experience in tax-related investment decisions.

Martin and Finke (2012) uses both the 2004 and the 2008 waves of the National Longitudinal Survey of Youth to estimate the impact of financial advice on retirement savings and the change in accumulated retirement wealth between 2004-2008.³³ The authors compare the effectiveness of creating one's own retirement plan versus using a professional advisor. The authors find that the use of a comprehensive financial professional overwhelmingly increases the likelihood that households will go through the process of calculating retirement needs. Respondents who rely on an advisor to help plan for retirement are more likely to own tax-advantaged accounts. Authors conclude that planning, with the help of a comprehensive advisor, improves retirement outcomes.

4. Increased savings

Montmarquette and Nathalie (2015) used Ipsos Reid collected data in the form of a 45-question internet survey from 18,333 Canadian Households.³⁴ The data were filtered to produce a high quality sample of 3,610 households. After splitting up the data into "advised households" and "non-advised households" the authors used econometric modelling in order to isolate the benefits of advisors in the accumulation of wealth.

Econometric results show that participants retaining the services of a financial advisor for more than 15 years have about 174 percent more financial assets (in other words, 2.73 times the level of assets) than non-advised respondents. The authors conclude that a highly plausible explanation for this finding comes from the greater savings and improved asset selection that is associated with having a financial advisor. Those investors who have advice are more likely to trust financial advisors, associate satisfaction with financial advisors and have confidence in financial advisors.

Similarly, in a KPMG Econtech (2009) paper based on the results of a regression analysis from an economy-wide model, the authors conclude that an individual who has a financial planner is estimated to save \$2,457 more in a year compared to similar individuals without

³³ Martin, T. K. and Michael S. Finke (2012), "*Planning for Retirement*," (December 31, 2012), available at SSRN: papers.ssrn.com/sol3/papers.cfm?abstract_id=2195138

³⁴ Montmarquette and Nathalie Viennot-Briot (2015), "The Value of Advice," *Annals of Economics and Finance*, 16-1, 69-94. This paper was also published as Montmarquette and Veinnot-Briot (2012), "Econometric Models on the Value of Advice of a Financial Advisor," at the Centre interuniversitaire de recherche en analyse des des organisations.

financial advisors/planners.³⁵ Investors with a financial planner have greater savings and investment balances than those who do not.

A study by Standard Life (2012) based on collected data from the UK, reports that the current average pension pot for consumers who have been advised on their retirement planning is £74,554.30, nearly double that of those not seeking advice.³⁶ Those who have taken advice put nearly a third more a month into their pension plan. On investments, people with an adviser save for longer and contribute more, leading to an average investment value which is over £40,000 higher than the average for those who haven't sought advice.

Lastly, Antunes, Macdonald and Stewart (2014) construct a hypothetical scenario using collected survey data that included age, average savings, average income and the presence of an advisor.³⁷ After collecting the data, the authors assume that 10 percent of the income of non-advised savers is now saved at the higher rate of those who do receive financial advice in order to capture the increased savings level that is correlated with having an advisor. This paper then applied the percentage difference between this savings rate and the baseline savings rate to the Conference Board of Canada's long term national forecasting model to quantify the economic impact of the increased savings in the long run. On top of positively impacting an investor's savings rate, the presence of an advisor was also shown to boost real GDP, turn consumer expenditures positive and raise the aggregate household savings rate.

5. Economies of scale with respect to the cost of information

In a highly-regarded paper by Stoughton, Wu and Zechner (2010), the authors create a model with three classes of agents: the active portfolio manager, the set of financial advisers and the pool of investors in the economy.³⁸ The authors first derive an equilibrium assuming that financial advisers are independent and must charge their investors their full costs in order to break even and allow portfolio manager to provide payments to the adviser. Then, the authors run the model to solve for the optimal amount of rebates preferred by the portfolio manager and

³⁵ "Value Proposition of Financial Advisory Networks" (2009), *KPMG Econtech*.
[www.fsc.org.au/downloads/uploaded/2009_1105_KPMGEcontech\(FinalReport\)_7d94.pdf](http://www.fsc.org.au/downloads/uploaded/2009_1105_KPMGEcontech(FinalReport)_7d94.pdf)

³⁶ Standard Life (2012), "Value of Advice Report," available on-line at www.unbiased.co.uk/Value-of-Advice-Report-2012.pdf

³⁷ Antunes, Pedro, Alicia Macdonald and Matthew Stewart (2014), "Boosting Retirement Readiness and the Economy Through Financial Advice," *The Conference Board of Canada*.

³⁸ Stoughton, Neal M., Yuchang Wu, and Josef Zechner (2010), "Intermediated Investment Management," *Journal of Finance*, 66, No. 3. 947-980.

the impact on management fees, fund sizes and flows. Finally, the paper derives the equilibrium without an adviser and compares all the scenarios. The authors find that financial advisers facilitate the participation of small investors in actively managed portfolios by economizing on information costs.

It is also interesting to note that the DOL itself wrote, in a 2011 cost benefit analysis of the final rule on investment advice under ERISA³⁹ (p. 66156) that “The Department therefore expects this final rule to produce cost savings by harnessing economies of scale and by reducing compliance burdens.” “For example, an adviser employed by an asset manager can share the manager’s research instead of buying or producing such research independently.”

D. The Cost of Losing Access to Professional Investment Advice

While the 2015 DOL regulatory impact analysis (RIA) ignored the costs of investors losing access to advice, the 2011 SEC staff’s 913 study as well as the 2011 DOL cost-benefit analysis, both mentioned above, both discussed the costs of investors not having access to advice.

We note that the DOL’s 2010 proposal differs from the current one in some of its details. However, both proposals raise the same troubling implications for current investors in commission-based accounts by increasing the complexity and compliance costs associated with offering that fee structure to customers.

1. Review of the SEC (2011) assessment: costs of imposing a fiduciary standard on brokers

As mentioned above, the SEC staff undertook a study in 2011 designed to evaluate the effectiveness of existing regulatory standards for investment advisers and brokers. The study was mandated under Section 913 of Title IX of the Dodd-Frank Act and analyzed some of the potential costs associated with changes to the current regulatory framework (see p.143-165), including imposition of a fiduciary standard on brokers.

In this section we review the discussion in SEC (2011) regarding the potential costs and expenses to retail customers, and the potential impact on the profitability of their investment

³⁹ See footnote 10.

decisions, including access to the range of products and services offered by broker-dealers, resulting from imposing on broker-dealers the fiduciary standard associated with the Investment Advisers Act of 1940.

The primary concern mentioned in SEC (2011) is with respect to the cost and availability to retail investors of accounts, products, services, and relationships with broker-dealers, which could inadvertently be eliminated or impeded (for example, through higher costs to brokers being passed on to investors).⁴⁰

In general imposition of a new regulatory standard of conduct on broker-dealers has the potential for additional costs on broker-dealers, which would be passed on to the customers at least in part, according to the standard economic theory of “effective incidence”. That theory simply states that it is likely that at least some portion of the regulatory costs imposed by the government is ultimately passed on to the public.⁴¹ In turn, costs passed on to retail investors would have the effect of eroding the profitability of their investments.

The net cost impact on retail customers would likely depend on a complex interplay of various factors, such as investor wealth, investor willingness to pay additional fees, and size of the particular broker-dealers in question as well as the competitive landscape. To take an extreme example, in relation to the UK experience, the FSA found⁴² that smaller firms and firms with less revenue were more likely to either exit the market or alter the types of services provided, in response to new government regulations.

The following discussion presents some further detail on specific concerns discussed in SEC (2011).

a. Brokers may deregister and register as investment advisers and, in the process, convert their brokerage accounts into advisory accounts subject to advisory fees.

One concern expressed in SEC (2011) associated with the imposition of a fiduciary standard is the possibility that brokers would convert existing accounts from commission-based

⁴⁰ See p. 155-159.

⁴¹ See, for example, Mukherjee, S. (2002), *Modern Economic Theory*, at p.833.

⁴² Oxera, *Retail Distribution Review Proposals: Impact on Market Structure and Competition*, prepared for the Financial Services Authority, Mar. 2010

accounts to fee-based accounts, in order to respond to new requirements placed on those account. The ultimate cost impact of this would depend on the actual fees and commissions, the relative extent to which the accounts in question had been actively trading, and any increased costs associated with providing advice for a fee.⁴³

Additionally, there could also be “fee layering” (whereby fees are charged based both on the value of the assets as well as account fees such as administrative and custodial fees), especially for less actively traded accounts.⁴⁴

An Oliver Wyman/SIFMA 2010 study⁴⁵ notes that there are significant cost differences between broker-dealer and advisory accounts, and if a change in the regulatory regime has the effect of pushing more clients toward the higher-cost model then this could be a suboptimal outcome for those investors. They estimate cumulative returns to retail customers with \$200,000 in assets would be reduced by \$20,000 over the next 20 years in such a scenario.

The 2011 SEC study states on p.162 that: “One possible way that costs could increase is if broker-dealers whose customers want advice and who currently provide the full range of brokerage services...for a single commission (or mark-up) and perhaps minor account level fees, simply converted these accounts to investment adviser status and cease to provide execution services to retail investors who sought advice. If that were the case, custody costs to the retail investors would be higher. Advice costs charged, at least initially upon conversion (and absent the investor researching competitors’ prices), would also be higher for those investors who buy and hold, because either an hourly or asset-based fee would likely exceed the current commission or mark-up on a retail trade.”

The 2011 SEC study goes on to note: “In sum, to the extent that broker-dealers respond to a new standard by choosing from among a range of business models, such as converting brokerage accounts to advisory accounts, or converting them from commission-based to fee-based accounts, certain costs might be incurred and ultimately passed on to retail investors in the

⁴³ See p. 155-159.

⁴⁴ See p. 172

⁴⁵ Oliver Wyman, Securities Industry and Financial Markets Association, Standard of Care Harmonization: Impact Assessment for SEC, Oct. 2010.

form of higher fees or lost access to services and products. Any increase in costs to retail investors detracts from the profitability of their investments.”⁴⁶

b. Broker-dealers may unbundle their services and provide them separately through affiliates or third parties.

The SEC (2011) study notes that broker-dealers might choose to unbundle their services and provide some of the component services through third parties.⁴⁷ A brokerage relationship involves various component functions: finding customers; providing advice to those customers; executing orders; clearance and settlement services; custodial services; and recordkeeping services, such as trade confirmations and account statements.

SEC (2011) argues that costs to broker-dealers are likely to depend on whether these services were provided by one firm or whether they were divided among affiliates. For example, a broker can self-clear securities transactions or contract with a third-party clearing broker to clear transactions. A broker can act as custodian for securities itself or contract with a third party such as a bank.

Brokers could decide to divide some or all of these functions. As noted in SEC (2011), to the extent broker-dealers may transfer accounts or personnel to affiliates, this may generate additional administrative costs.

2. The DOL (2011) Federal Register Study

While the most recent 2015 DOL RIA did not provide estimates of the cost to investors of losing professional investment advice, an earlier DOL (EBSA) study in 2011, previously cited, did in fact do so. The 2011 DOL *Federal Register* article published the final rule relating to the provision of professional investment advice to plans and beneficiaries of IRAs, under ERISA.

The 2011 DOL publication explicitly argues that participants in participant-directed retirement savings accounts make mistakes. In particular, the study notes (p.66151) that:

⁴⁶ See p. 162.

⁴⁷ See p. 164, 173.

“such mistakes and consequent losses historically can be attributed at least in part to provisions of the Employee Retirement Income Security Act of 1974 that effectively preclude a variety of arrangements whereby financial professionals might otherwise provide retirement plan participants with expert investment advice. Specifically, these ‘prohibited transaction’ provisions of section 406 of ERISA and section 4975 of the Internal Revenue Code prohibit fiduciaries from dealing with DC plan or IRA assets in ways that advance their own interests.”

The DOL estimates this error rate costs an aggregate of “more than \$114 billion in 2010” (p.66151). The study goes on to say (p. 66159) that: “The Department is highly confident in its conclusion that investment errors are common and often large, producing large avoidable losses (including foregone earnings) for participants. It is also confident that participants can reduce errors substantially by obtaining and following good advice. While the precise magnitude of the errors and potential reductions therein are uncertain, there is ample evidence that that magnitude is large.”

The DOL then argued that the PPA, by permitting a broader array of investment advice under ERISA, decreased the amount of errors made by investors. For example, the study states (p.66152): “the Department believes this final regulation will provide important benefits to society by extending quality, expert investment advice to more participants, leading them to make fewer investment mistakes. The Department believes that participants, after having received such advice, may pay lower fees and expenses, engage in less excessive or poorly timed trading, more adequately diversify their portfolios and thereby assume less uncompensated risk, achieve a more optimal level of compensated risk, and/or pay less excess taxes.”

The DOL estimated that the reduction in investment errors due to the expansion of availability of investment advice would amount to between \$7 billion and \$18 billion annually, or approximately 6 percent to 16 percent of the \$114 billion total in investment errors made per year.⁴⁸ At the upper range these numbers are as large as the supposed cost of conflicted advice that the DOL Fiduciary Standard is designed to alleviate.

⁴⁸ The DOL stated that it based its estimates on the retirement assets in DC plans and Individual Retirement Accounts reported by the Federal Reserve Board’s Flow of Funds Accounts (Mar. 2011), at www.federalreserve.gov/releases/z1/Current/. The study also refers the reader to earlier DOL studies including 74 FR No 164 (Aug. 22, 2008), 74 FR No 12 (Jan. 21, 2009), and 75 FR No 40 (Mar. 2, 2010).

The investment mistakes discussed in the 2011 RIA are grounded in the behavioral finance literature, which we have discussed in detail above. For example, the DOL stated (p. 66153) that “in practice many investors do not optimize their investments, at least not in accordance with generally accepted financial theories. Some investors fail to exhibit clear, fixed and rational preferences for risk and return. Some base their decisions on flawed information or reasoning. For example some investors appear to anchor decisions inappropriately to plan features or to mental accounts or frames, or to rely excessively on past performance measures or peer examples. Some investors suffer from overconfidence, myopia, or simple inertia.”

The study then goes on to focus on five types of investment mistakes:

- a) *Fees and Expenses*. The DOL stated that it believes that (p. 66153) “there is a strong possibility that at least some participants, especially IRA beneficiaries, pay inefficiently high investment prices.” However, it is not clear what empirical evidence the DOL used as its basis for this statement.
- b) *Poor Trading Strategies*. The study cited churning, failure to rebalance, attempts to time the market, and chasing past returns as examples of strategies that tend to underperform.
- c) *Inadequate Diversification*. The DOL claims that DC plan participants sometimes concentrate their assets excessively in stock of their employer, as well as being under-invested in international equity or debt.
- d) *Inappropriate Risk*. The study notes that investors may construct portfolios that are too risky or too safe, given their preferences.
- e) *Excess Taxes*. The DOL study mused that some households appear to follow sub-optimal strategies with respect to minimizing taxes, such as not placing taxable bonds in tax-deferred accounts. However, the DOL also stated that (p. 66154) “the Department currently has no basis to estimate the magnitude of excess taxes that might derive from participants’ investment mistakes.”

Despite the rather lengthy description of the above types of investment errors, the DOL did not use data from actual investor-held accounts to estimate the magnitude of the associated losses. Instead, they made a variety of assumptions, summarized as follows:

- 1) The DOL assumed that approximately 40 percent of DC plan sponsors provided access to investment advice before the PPA.⁴⁹ After enactment of the PPA, they assumed this percentage increased to between 56 and 69 percent.
- 2) They assumed that about 25 percent of plan participants that are offered advice use the advice (both pre-PPA and post-PPA). For IRAs, they assumed that 33 percent used advice pre-PPA, and between 50 percent and 80 percent post-PPA.^{50,51}
- 3) Investors who received advice make mistakes about half as often as those who are unadvised (they also consider other fractions).

Finally, the above assumptions are combined with the previously mentioned assumption that aggregate investment errors cost consumers about \$114 billion per year to arrive at the final estimates of between \$7 billion to \$18 billion per year from having increased access to professional investment advice.

Taking the DOL’s methodology and results at face value, by their own calculations the loss of access to advice, by even a small fraction of investors, would result in investment errors so large as to be of the same magnitude as the problem that the DOL is purportedly trying to solve—the “cost of conflicted advice,” by the DOL’s own reckoning, is on par with the losses that would be incurred by a government policy that curtails the availability of professional investment advice.

III. THE COST OF CONFLICTED INVESTMENT ADVICE

We begin with a review of the claims of harm associated with purportedly conflicted investment advice, as put forth in White House memo entitled “The Effects of Conflicted Investment Advice on Retirement Savings” (“WH/CEA memo”) published in February 2015 and the Department of Labor’s (DOL) proposed conflict of interest rule and definition of the term

⁴⁹ The DOL attributed these numbers at least partly to surveys including Hewitt Associates LLC, *Survey Findings: Hot Topics in Retirement, 2007* (2007); Profit Sharing/401(k) Council of America, *50th Annual Survey of Profit Sharing and 401(k) Plans* (2007); and Deloitte Development LLC, *Annual 401(k) Benchmarking Survey, 2005/2006 Edition* (2006).

⁵⁰ These are based on Employee Benefit Research Institute, *2007 Retirement Confidence Survey, Wave XVII*, Posted Questionnaire (Jan. 2007); Hewitt Associates LLC, *Survey Findings: Hot Topics in Retirement, 2007* (2007); Profit Sharing/401(k) Council of America, *50th Annual Survey of Profit Sharing and 401(k) Plans* (2007); and Deloitte Development LLC, *Annual 401(k) Benchmarking Survey, 2005/2006 Edition* (2006).

⁵¹ It is interesting to note that the DOL assumed that “a large majority of IRA beneficiaries who invest in mutual funds purchase them via such professionals.”

“fiduciary” under ERISA (the “proposal”), and associated Regulatory Impact Analysis (“RIA”).^{52,53}

The estimates in these documents form the basis of the Department of Labor’s argument that the proposed conflict of interest rule would “benefit” the public. The Regulatory Impact Analysis in particular purports to quantify these benefits in dollar terms. As shown in detail in the next section, however, the RIA fails to do so. The RIA produces many different numbers representing different underlying assumptions, and results in estimates that vary wildly over an incredible set of values. This range of numbers is so wide as to suggest no scientific confidence in the DOL’s methodology. As a result, the estimates in the RIA provide little confidence as to the actual benefits, if any, arising from the DOL’s proposal.

A. Estimates of the Benefits of the Proposal Vary Wildly in the RIA

In the WH/CEA memo entitled “The Effects of Conflicted Investment Advice on Retirement Savings” published in February 2015, the authors estimated that a baseline aggregate cost to consumers from purportedly conflicted advice is about \$17 billion per year. They calculated this number as one percent times the total number of mutual funds and variable annuities in IRAs. The one-percent factor came from their assessment of an average of estimates produced by various academic papers using differing methodologies and datasets.

However, this number does not appear in the subsequent DOL Regulatory Impact Analysis published two months later in April 2015. Instead, the RIA provides many different numbers, all generated by different sets of assumptions.

Table 5 summarizes the various estimates of the cost of purportedly conflicted advice that appeared in the RIA. A review of the table indicates an astounding range of different estimates. On the low end, there is mention in three separate places in the RIA (p. 8, p. 102, and p. 106) of an estimated cost from \$20 billion to \$22 billion over a ten year horizon. These numbers appear to come from an analysis that assumes the new DOL rules will eliminate 50 percent of

⁵² 29 CFR 2509 and 2510, DOL, Definition of the Term “Fiduciary”; Conflict of Interest Rule-- Retirement Investment Advice; Proposed Rule in Federal Register Volume 80, Number 75 (Monday, April 20, 2015), Pages 21927-21960.

⁵³ “Fiduciary Investment Advice Regulatory Impact Analysis”, Department of Labor, Available on-line at <http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf>.

underperformance due to front-end-load sharing, and that this is the only effect considered. These numbers equate to between \$2 billion to \$2.2 billion per year (setting aside discount rates and any growth in the asset base over time), which are about 13 percent of the WH/CEA memo's \$17 billion per year estimate.

On the high range, the RIA states on p. 7 and p. 98 that the costs of conflicted advice could be “nearly \$1 trillion” over a horizon of 20 years. This is consistent with approximately \$50b in costs per year (again, setting aside discount rates, compounding of returns and other dynamic assumptions the DOL may have made). The estimate seems to come from an analysis in which it is assumed that investors lose 200 basis points (two percentage points) of annualized return per year due to “conflicted advice,” instead of the 100 bps (one percentage point) assumed in the WH/CEA memo. It is not clear where the 200 bps number comes from. Nor is it clear why this number is so large, given that simply doubling the 100 bps number should approximately double the estimate from \$17 billion per year to \$34 billion per year. Presumably, the DOL increased the number from \$34 billion to \$50 billion by apparently compounding returns over time, but the RIA does not specify this in enough detail to be certain.

One reason for the incredible range in aggregate estimates is that the RIA numbers vary in terms of the horizon of interest (some are per year, some cover a 10-year horizon, and some cover a 20-year horizon), assumptions made (e.g., some assume a 100 bps reduction in investment performance, and others assume a 200 bps reduction in performance), and the universe of assets that are considered (e.g., some consider all mutual funds held in individual retirement accounts (“IRAs”) while others focus only on front-end load mutual funds, and so forth).

Nevertheless, given the variety to the DOL's own numbers, the “benefit” estimates do not provide a credible foundation on which to base significant changes in policy and regulation. The very wide range in the numbers suggests that the DOL itself does not have a good measure of the dollar magnitude of purportedly conflicted advice that they seek to ameliorate.

This range of numbers is so wide as to provide no scientific confidence in the DOL's own methodology, and is inconsistent with a cost-benefit analysis that is concrete enough to form the basis of a change to federal government policy.

An additional problem with the “benefits” of the proposal, as presented by the DOL, is that the academic literature on which they base their argument does not directly apply to the question of how to best define and implement a fiduciary standard under ERISA.

B. The RIA Misapplies the Academic Literature

In this section, we discuss some important ways in which the RIA misapplies the existing academic literature in an attempt to justify the DOL proposal.

Before discussing the methodological shortcomings, we note that much of the academic literature which is cited by the RIA is based on data which is now dated and may no longer be relevant. Significant changes have occurred in the past several years. Indeed, one of the most salient recent developments is that mutual fund fees have been declining substantially, and that has occurred independently of any explicit government driven interventions.

Over the period 1990-2013, front-end sales loads have declined by nearly 75 percent for equity funds and hybrid funds, and even more than that for bond funds.⁵⁴ The ICI argues this decline, at least in part, may reflect the increasing role of mutual funds in helping investors save for retirement. That is, mutual funds now often waive load fees on purchases made through defined contribution plans, such as 401(k) plans.

Additionally, nearly all net new cash flows in recent years have accrued to no-load mutual funds. Net flows to load mutual funds have been negative for all four years of the most recent data.⁵⁵

1. The cited literature focuses on mutual funds, yet the DOL applies the results more widely

The academic research that serves as the basis for conflicted cost-of-advice estimates focuses on the commissions embedded in mutual fund purchases and sales. These are typically front-end loads, although there may be back-end loads and on-going fees such as 12b-1 fees.⁵⁶

⁵⁴ See Chapter 5 of the 2014 Investment Company Fact Book, *Mutual Fund Expenses and Fees*, available on-line at http://www.icifactbook.org/fb_ch5.html

⁵⁵ *Id.*, in Figure 5.10.

Yet the DOL proposal extends far beyond mutual funds. To cite one example, the proposal ends the existing prohibited transaction exemption for variable annuities and states that they would be able to be sold only under existing compensation structures under the Best Interest Contract Exemption. Other assets classes, such as options on stocks, do not appear to be permitted for sale to IRA accounts under any of the proposed exemptions.

There is no justification provided, therefore, as to why the DOL would propose making such radical shifts to the way in which all assets are sold to IRA account holders, given that the academic literature on which the RIA relies so heavily is almost exclusively limited to the mutual fund literature. There is no basis in the academic literature for extrapolating conclusions applicable to mutual funds to other investment products that may not even have front-end sales loads.

2. The research cited in the RIA takes results associated with higher-than-average load funds and misapplies them to all funds.

One of most heavily cited academic papers in the RIA is Christoffersen, Evans and Musto (2013).⁵⁷ It is cited dozens of times, and is one of the leading sources of the baseline estimate of 100 bps per year in apparent “cost of conflicted advice” that the DOL claims is suffered by investors in commission-based retirement accounts.

It is therefore important to understand the claims that actually appear in Christoffersen et al. (2013). In particular, their study finds evidence that a subset of funds, those whose front-end loads are higher than other funds with similar characteristics, underperformed the average return of their fund category during the next year. In formulating much of their “cost of conflicted advice” aggregate figures, the DOL then assumes that *all* IRAs invested in front-end load funds

⁵⁶ The RIA attempts to portray brokers and investment advisers in the professional IRA market as charging excessive fees to investors, yet it fails to mention one of the most salient developments in recent years – namely, that mutual fund fees have been declining substantially. It is notable that this has occurred independently of any explicit government driven interventions. Investment Company Institute (ICI) expense ratio data for three broad types of mutual funds over the years 2000-2013 indicate, for example, that in 2000 equity mutual fund investors incurred average expense ratios of 99 basis points. By 2013, that number fell to 74 basis points, a decline of 25 percent. The same basic pattern is true for hybrid and bond funds. In terms of front-end sales loads, it is again the case that they have declined substantially over time with no explicit government intervention. Over the period 1990-2013, they have declined by nearly 75% for equity funds and hybrid funds, and even more than that for bond funds. Additionally, nearly all net new cash flows in recent years have accrued to no-load mutual funds. Net flows to load mutual funds have been negative for all four years of the most recent data. See Chapter 5 of the 2014 Investment Company Fact Book, *Mutual Fund Expenses and Fees*, available on-line at http://www.icifactbook.org/fb_ch5.html

⁵⁷ Christoffersen, Susan E. K., Richard Evans, and David K. Musto (2013) “What Do Consumers’ Fund Flows Maximize? Evidence from Their Brokers’ Incentives,” *Journal of Finance*, Vol. 68(1), p. 201-235.

suffer the same underperformance, thereby mistakenly applying a result from a subset of load funds to all load funds.

The extrapolation the DOL made is analogous to the following: Suppose we conduct medical research and find that people who consume more salt than average have a lower life expectancy by five years, and we then conclude that eating no salt will increase the life expectancy of everyone by five years. This is a logical fallacy. We have no evidence that people who eat a “normal” amount of salt would benefit from reduced salt intake, and so extrapolating to them is an error in logic.

Again, we emphasize this point because an official cost-benefit analysis needs to be precise and free of logical fallacies. By incorrectly extrapolating from a subset of mutual funds to all mutual funds, the DOL is effectively applying the 100 bps cost number to assets for which it does not apply. Hence, the benefit side of the cost-benefit analysis presented in the RIA is seriously flawed. The result is that it is impossible to conclude whether the benefits of the DOL proposal outweigh the costs.

3. The academic literature cited in the RIA does not compare the costs and benefits of fiduciary accounts with those of brokerage accounts

The academic literature on which the DOL relies, such as Christoffersen, Evans, and Musto (2013), Bergstresser, Chalmers, and Tufano (2009),⁵⁸ Del Guercio and Reuter (2014),⁵⁹ generally compares the performance of mutual funds with loads (paid as commission to brokers) versus mutual funds sold directly to the public.

None of these academic studies actually compares the performance of accounts with a financial advisor who is a fiduciary to the performance of accounts with a broker or other financial advisor that is not a fiduciary. Hence they are using results that do not address the central question of the proposal. It is absolutely inappropriate to conclude that investors would

⁵⁸ Bergstresser, Daniel, John Chalmers, and Peter Tufano (2009), “Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry”, *The Review of Financial Studies*, 22(10), p. 4129-4156.

⁵⁹ Del Guercio, Diane and Jonathan Reuter (2014) “Mutual Fund Performance and the Incentive to Generate Alpha”, *The Journal Of Finance*, Vol. 69(4), p. 1673-1704.

be better off under an expanded fiduciary standard on the basis of the academic literature being cited.

The bulk of the literature considers data at the mutual fund level and measures their loads and performance. These can be compared to direct-to-public investments such as a “S&P 500” index fund. The academic research generally has not undertaken a direct way of comparing how investors would fare under a fiduciary standard in relation to a broker-based suitability model or a self-direction model because that analysis requires account-level data from actual investors, rather than aggregate fund-level data.⁶⁰

Absent account-level data, the DOL is drawing fallacious conclusions. Even if it were true that fund loads cause underperformance—which is not proven—there is no reason to conclude that consumers would be better off in fiduciary advised accounts based on the evidence cited by the DOL. Fiduciary advisors do not work for free. They must also be compensated for their work, and in some cases they may be providing a great deal more service than a commission-based non-fiduciary broker and may need even more compensation. If certain investors are forced out of commission-based accounts, they may either lose access to advice entirely, or they may switch to advisory accounts which may charge more, not less. Moreover, this increased expense is likely to be particularly acute for low-balance and low-activity accounts who may pay very low annual fees and loads because their portfolios tend to be static. Hence the DOL proposal is likely to disproportionately hurt low-income Americans.

⁶⁰ A small number of academic papers have looked at account-level data, but these are generally limited to extremely small sample sets that are not in any way representative of the spectrum of American consumers. For example, Chalmers and Reuter (2014) collect account level data, but it is limited to faculty and administrators in the Oregon University’s optional retirement plan (ORP). See Chalmers, J. and J. Reuter (2014), “What is the Impact of Financial Advisors on Retirement Portfolio Choices and Outcomes?” working paper, University of Oregon.

Table 5
The Cost of Conflicted Advice Estimated by DOL Varies Widely

Entry (1)	Page (2)	Amount (3)	Horizon (4)	Methodology (5)	Notes (6)
Estimates found in <i>The Effects of Conflicted Investment Advice on Retirement Savings</i> ¹					
1	2	\$17 bil.	per year	100 bps (from academic lit) * \$1.7 trillion assets in IRA funds	N/A
Estimates found in <i>Fiduciary Investment Advice: Regulatory Impact</i> ²					
1	7	100 bps	per year	"Careful review" of academic literature	N/A
2	7, 98	\$210 bil.	10 years	Applying performance gap (100 bps based on academic lit) to the current IRA marketplace	100 bps figure is the average underperformance associated with conflicts of interest in the mutual funds segment
3	7, 98	\$500 bil.	20 years	See above	N/A
4	7, 98	\$430 bil.	10 years	Applying performance gap (200 bps based on academic lit) to the current IRA marketplace	200 bps figure is based on academic studies that suggest that the underperformance of broker-sold mutual funds may be even higher than 100 bps, possibly due to loads that are taken off the top and/or poor timing of broker sold investment
5	7, 98	"nearly" \$1 tril.	20 years	See above	On pg. 8 the RIA also mentions that adviser conflicts "could cost IRA investors as much as \$410 bil. over 10 years and \$1 tril. over 20 years. The \$410 bil. number seems to come from the 200 bps points, but the RIA is unclear

6	8	\$410 bil.	10 years	DOL estimate based on reduction in excessive trading, associated transaction costs, timing errors, improvements in performance of IRA investments other than front-load mutual funds	See above
7	8, 101	\$40-44 bil.	10 years	DOL estimate based of assumption that rule will eliminate 100 percent of underperformance due to variable front-end-load sharing	"Baseline scenario" where the 1975 rule remains in place. Loads projected to decrease over time at the same rate as the baseline scenario. Quantifying gains expected to accrue to IRA investments in front-end load mutual funds attributable to variations in load sharing. DOL considers this estimate "conservative". Quantified gains pertain only to 13 percent of all IRA assets that are involved in front-end-load mutual funds
8	8, 101	\$88-100 bil.	20 years	See above	See above
9	8, 102, 106	\$30-33 bil.	10 years	DOL estimate based of assumption that rule will eliminate 75 percent of underperformance due to variable front-end-load sharing	The Report offers no basis for the selection of 75 percent underperformance
10	8, 102, 106	\$20-22 bil.	10 years	DoL estimate based of assumption that rule will eliminate 50 percent of underperformance due to variable front-end-load sharing	The Report offers no basis for the selection of 50 percent underperformance

11	105	\$44.1 bil.	10	Loads decrease over time at twice the rate of the baseline scenario. Quantifying gains expected to accrue to IRA investments in front-end load mutual funds attributable to variations in load sharing and increased investment performance for broker-sold mutual funds. The DOL considers this estimate "reasonably high" Quantified gains pertain only to 13 percent of all IRA assets that are involved in front-end-load mutual funds	N/A
12	105	\$99.7 bil.	20	See above	N/A
13	105	\$65.6 bil.	10	Represents upper limit. Loads paid by investors immediately fall to zero Quantifying gains expected to accrue to IRA investments in front-end load mutual funds attributable to variations in load sharing and increased investment performance for broker-sold mutual funds. The DOL considers this to be an "illustration but does not expect the proposal to result" in this number. Quantified gains pertain only to 13 percent of all IRA assets that are involved in front-end-load mutual funds	N/A
14	105	\$135.1 bil.	20	See above	N/A
15	98	\$18 bil.	per year	Applying performance gap (100 bps) to the current IRA marketplace	N/A

16	98	\$10 bil.	per year	Christoffersen, Evans, and Musto (2013) find that each 100 basis points in load sharing paid to an unaffiliated adviser reduces future returns by 50 bps and 100 bps paid to a captive broker reduces future performance by 15 bps. Authors of the RIA project these results onto the current IRA marketplace	N/A
17	98	\$125 bil.	10 years	See above	N/A
18	98	\$285 bil.	20 years	See above	N/A
19	98	\$26 bil.	per year	Harm to consumers if industry has simply shifted conflicted revenue streams, rather than reducing conflicts	This refers to a hypothetical where the industry shifts away from front-end load mutual funds into other revenue streams with conflicts of interest. Appears to be based off of Christoffersen, Evans, and Musto (2013).
20	98	\$300 bil.	10 years	See above	See above
21	98	\$700 bil.	20 years	See above	See above
22	101	\$80 bil.	10 years	Underperformance seen by focusing only on how load shares paid to brokers affect the size of loads IRA investors holding load funds pay and the returns they achieve	The Report assesses the gains to investors attributable to the rule by specifically quantifying benefits in an area of the IRA market where the conflicts are well measured—namely front-end load mutual funds
23	101	\$200 bil.	20 years	See above	See above

Sources:

¹ *The Effects of Conflicted Investment Advice on Retirement Savings*. The White House. February 2015

² *Fiduciary Investment Advice: Regulatory Impact Analysis*. The Department of Labor

APPENDIX: THE COST OF COMPLYING WITH THE DOL PROPOSAL

The Regulatory Impact Analysis published by the DOL also reported estimates for the costs of implementing the DOL's new Fiduciary Standard rules. These are essentially limited to compliance costs.

A detailed overview is presented in Table 6. Turning to the top row, compliance costs are estimated to range from range from \$240 million to \$570 million per year (equivalently, \$2.4 billion to \$5.7 billion over a 10 year horizon, abstracting from applying discount rates, inflation corrections or other dynamic adjustments).

Perhaps more important than the baseline numbers, however, is the incredibly complex and opaque, ad hoc, methodology and set of assumptions which were used to formulate these estimates.

For example, The DOL's cost estimates for complying with the DOL's proposed fiduciary rule rely on data submitted by SIFMA to the SEC in 2013 (the "SIFMA Data").⁶¹ The SIFMA Data was collected and submitted by SIFMA to the SEC for the purpose of estimating the costs of complying with potential SEC fiduciary rule changes under Dodd-Frank Section 913.⁶² Although the DOL states that "*there will be substantive differences between the [DOL]'s new proposal and exemptions and any future SEC regulation that would establish a uniform fiduciary standard...*", the DOL nevertheless relies on the SIFMA Data as part of the basis for its cost estimates.⁶³ DOL's stated reason for doing so is that there are "*some similarities between the cost components*" in the SIFMA Data and the costs that would be required to comply with the DOL proposal.

However, the phrase "some similarities" implies there are some differences and the DOL is, by definition, unable to address the compliance costs that may arise due to such differences in the two regulatory regimes in question.

The SIFMA Data estimates the costs of implementing an SEC-established uniform fiduciary standard in two parts. The first was the cost for broker-dealers to develop and maintain

⁶¹ Regulatory Impact Analysis, <http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf>, at pp. 160 – 65.

⁶² SIFMA Comment to SEC dated July 5, 2013, <http://www.sifma.org/issues/item.aspx?id=8589944317>.

⁶³ Regulatory Impact Analysis at p. 161.

a disclosure form and customer relationship guide, similar to the Form ADV Part 2A that registered investment advisors use today.

The DOL proposal does *not* require a Form ADV Part 2A-type disclosure for broker-dealers, but it would require an extensive range of new disclosure obligations that do not exist today. These include: (i) contractual disclosures under the Best Interests Contract Exemption, (ii) point of sale disclosure, including the total cost of the acquired asset over periods of 1, 5, and 10 years; (iii) annual fee and compensation disclosure; (iv) public website disclosure, including a list of all direct or indirect material compensation; and (v) aggregated data regarding inflows, outflows, holdings, and returns, including the identity and amounts of revenue received, which DOL reserves the right to publicly disclose.

The disclosure estimates in the SIFMA Data are for broker-dealers to adopt an essentially “known quantity” disclosure form that is used by advisors today. The disclosure estimates in the SIFMA Data do not address any of the new disclosure obligations in the DOL proposal. Hence it is erroneous for DOL to use SIFMA’s disclosure estimates to approximate the costs of the extensive, new, separate and distinct, disclosures required under the DOL proposal.

The second part of the SIFMA Data is the estimated cost of implementing compliance oversight and training programs to adapt to a new SEC standard. In providing these estimates, SIFMA member firms were asked to make a host of assumptions. None of these assumptions, however, include the new obligations and potential liabilities that the DOL proposal may create, including: (i) new contractual liability under the Best Interest Contract Exemption, including potentially significant individual and class action litigation exposure; (ii) compliance with a new DOL exemption in order to engage in principal transactions; (iii) new restrictions on products that may be offered and sold, and (iv) the costs of creating the new data and information that are subject to the new disclosures outlined above.

In sum, the SIFMA Data applies to estimating the cost of a contemplated SEC fiduciary regime, under specific assumptions that were applied to such a contemplated SEC approach. It is not methodologically appropriate to use the SIFMA Data to estimate the cost of a separate and distinct DOL regime, with separate and distinct requirements, obligations, liabilities, and costs.

The DOL further compounds the apparent inconsistency by relying on the SIFMA Data and then suggesting that “*the SIFMA submission significantly overestimates the costs of the new*

proposal.”⁶⁴ The DOL thus appears to be relying on inputs into its cost analysis that it does not view as accurate, thereby undermining the reliability of its own methodology.

Lastly, we note that the US Chamber of Commerce submitted a comment letter to the OMB on May 20, 2015 outlining their view that the Department of Labor vastly underestimated the compliance costs associated with the proposed Fiduciary rule.⁶⁵ Specifically, the Chamber states (on p. 2) that real costs associated with the information collection requests alone may be “five to ten times greater” than the DOL’s estimate of \$792 million over ten years. The ten-page letter goes on to detail the various shortcomings and implausible assumptions made by the DOL in their calculations.

While we will not undertake to comment on the OMB letter, it does serve to emphasize the clear shortcoming of the DOL’s estimates. Namely, they are not based on a scientific or empirical approach and the resulting estimates may or may not be wildly inaccurate reflections of the true costs. As a result, it would be inappropriate to include them as part of a formal assessment of the costs and benefits of a proposed change in public policy.

⁶⁴ Regulatory Impact Analysis at p. 162.

⁶⁵ Available on-line at http://www.uschamber.com/sites/default/files/oira_comments.pdf.

Table 6
The Costs of Compliance Are Based on Complex and Opaque Set of Assumptions

Estimates found in *Fiduciary Investment Advice: Regulatory Impact*¹

Page (1)	Source (2)	Amount (3)	Horizon (4)	Notes (5)
157	Department of Labor Estimate	\$2.4b-5.7 bil.	10 years	Total compliance cost. Cost mostly reflects the costs incurred by new fiduciary advisers to satisfy relevant PTE conditions
162	SIFMA estimate of average start up cost to develop and implement new, comprehensive supervisory systems, procedures and training	\$5 mil.	one year	Estimated costs that would be incurred by broker-dealers
162	SIFMA estimate of annual on-going costs	\$2 mil.	annual	
165	DOL estimated start-up cost of compliance for medium firms based on values provided by SIFMA	\$663,000	one year	\$5 million x (0.133). 0.133 is the estimated ratio of medium firms and large firms' cost based on figures provided for RIAs in the IAA comment letter
165	DOL estimated start-up cost of compliance for small firms based on values provided by SIFMA multiplied by DoL's ratio	\$242,000	one year	5 million x (0.048). 0.048 is the estimated ratio of small firms and large firms' cost based on figures provided for RIAs in the IAA comment letter
166	DOL total estimated start-up cost of compliance in the first year	\$892 mil.	one year	
165	DOL estimated on-going cost of compliance for medium firms	\$265,000	annual	\$2 million x 0.133 (the IAA ratio)
165	DOL estimated on-going cost of compliance for small firms	\$96,900	annual	\$2 million x 0.048 (the IAA ratio)
166	DOL estimated on-going cost of compliance after first year	\$357 mil.	annual	
166	Estimated start-up cost of compliance for large firms based on values provided by the IAA	\$1 mil.	one year	
166	DOL estimated start-up cost of compliance for medium firms based on values provided by the IAA	\$145,000	one year	The DoL took the ratio between the cost SIFMA and IAA provided (.2181) and derived the costs from that ratio referred to as the

"ADV ratio"

166	DOL estimated start-up cost of compliance for small firms based on values provided by the IAA	\$53,000	one year	SIFMA estimates multiplied by ADV ratio
166	DOL total start-up cost of compliance after first year based on IAA	\$195 mil.	one year	See above
166	Estimated on-going cost of compliance for large firms based on values provided by the IAA	\$436,000	annual	See above
166	Estimated on-going cost of compliance for medium firms based on values provided by the IAA	\$58,000	annual	SIFMA estimates multiplied by ADV ratio
166	Estimated on-going cost of compliance for small firms based on values provided by the IAA	\$21,000	annual	See above
166	DOL estimated total annual ongoing costs for subsequent years based on IAA	\$78 mil.	annual	See above

Cost of Developing and Maintaining a Disclosure Form and Customer Relationship Guide

161	SIFMA reported start-up cost for preparing a relationship guide similar to the Form ADV 2A	\$2.8 mil.	one year	
161	SIFMA reported "low" start up cost	\$1.2 mil.	one year	
161	SIFMA reported "high" start-up cost	\$4.6 mil.	one year	
161	SIFMA reported average annual on-going cost	\$631,000	annual	

Costs Incurred by Registered Investment Advisors

166	DoL Analysis of cost for legal consultation for small firms	\$3,840	one year	Hourly rate of \$480. 8 hours assumed
166	DoL Analysis of cost for legal consultation for medium firms	\$7,680	one year	Hourly rate of \$480. 16 hours were assumed.
166	DoL Analysis of cost for legal consultation for large firms	\$19,200	one year	Hourly rate of \$480. 40 hours were assumed.
167	DoL Analysis of costs of training for a large firm in the first year	\$30,000	one year	
167	DoL Analysis of costs of training for a large firm after the first year	\$10,000	annual	
167	DoL Analysis of costs of training for a medium firm in the first year	\$4,000	one year	

167	DoL Analysis of costs of training for a medium firm after the first year	\$1,500	annual
167	DoL Analysis of costs of training for a small firm in the first year	\$1,500	one year
167	DoL Analysis of costs of training for a small firm after the first year	\$1,500	annual
167	Total cost to evaluate compliance with rule and provide training for a large RIA firm in the first year	\$49,200	one year
167	Total cost to evaluate compliance with rule and provide training for a medium RIA firm in the first year	\$11,700	one year
167	Total cost to evaluate compliance with rule and provide training for a small RIA firm in the first year	\$5,300	one year
167	Total cost to evaluate compliance with rule and provide training for a large RIA firm in the subsequent years	\$10,000	annual
167	Total cost to evaluate compliance with rule and provide training for a medium RIA firm in the subsequent years	\$1,500	annual
167	Total cost to evaluate compliance with rule and provide training for a small RIA firm in the subsequent years	\$500	annual
167	Total Cost for IRA firms in the first year	\$110.8 mil,	one year
167	Total Cost for IRA firms in the subsequent years	\$11.9 mil.	annual

Costs Incurred by Plan Service Providers

168	Start-up cost for a large firm	\$49,000	one year	2,275 small service providers, 437 medium service providers, 142 large service providers
168	Start-up cost for a medium firm	\$12,000	one year	
168	Start-up cost for a small firm	\$5,000	one year	
168	Aggregate start-up cost for training employees	\$24.1 mil.	one year	
169	On-Going Costs for small firm	\$10,000	annual	
169	On-Going Costs for medium firm	\$2,000	annual	
169	On-Going Costs for large firm	\$1,000	annual	
169	Aggregate on-going costs for training employees, yearly	\$3.2 mil.	annual	

2,275 small service providers, 427 medium service providers, 142 large service providers

Additional Costs

171	Increased insurance premiums for consultants, firms and broker-dealer representatives	premiums for these affected service providers could be expected to increase 10 percent; average insurance premium is \$3,000 per representative. Premium increase would be \$300 per insured	N/A	DoL estimates that 50% of the cost reflects the expenses and profits of insurance carriers, while the remainder is not a cost but a transfer in the form of compensation paid to those harmed by the insured fiduciary investment adviser
172	one year premium increase for broker dealer representatives	\$87 mil.	one year	290,000 broker dealers multiplied by \$300
173	Cost of premiums and transfers from firms to plans or IRA investors	\$63 mil.	annual	418,00 BD representatives and plan service provider employees could experience a \$300 increase. 50% is paid out as compensation and 50% is paid to the insuring firm
174	First year cost for each BD representative converting to RIA status	\$5,600	one year	50 hours preparing for Series 65 exam (at \$106.06/hour) plus additional costs
174	Total first year cost of BD to RIA conversion	\$59.4 mil.	one year	
174	Ten year cost of BD to RIA conversion	\$445 mil.	ten years	
177	first year cost for producing and distributing the disclosures and subsequent compliance	\$77.4 mil.	one year	
177	on-going cost for subsequent years for producing and distributing disclosures	\$29.2 mil.	annual	
177	first year cost of the 6.3 million disclosures required under the new Principal Transactions PTE	\$57.4 mil.	one year	
	on-going cost of the 6.3 million disclosures required under the new Principal Transactions PTE	\$47.8 mil.	annual	
177	Disclosure requirements required by the amended PTE 86-128	\$198,000	annual	
177	Seller's Carve-Out disclosures	\$6.2 mil.	annual	Assumes 43,000 disclosures

178	The Platform Provider Carve-Out	\$39,000	annual	Assumes 1,800 disclosures
178	The Investment Education Carve-Out	\$121,000	annual	Assumes 2,800 disclosures
178	Total exemptions and carve-outs cost in the first year	\$141.5 mil.	one year	Assumes 92.4 million additional disclosures
178	Total exemptions and carve-outs cost in the subsequent years	\$83.5 mil.	annual	
178	Total exemptions and carve-outs cost in 10 years	\$791.8 mil.	10 years	

Mentioned But Not Quantified

175	Increased traffic in Call Centers
176	Cost of creating or updating contracts
176	transitional impacts on the financial sector market
176	impact on asset providers
177	costs for complying with the new and amended PTEs

Sources

- ¹ *Fiduciary Investment Advice: Regulatory Impact Analysis*. The Department of Labor

Our work in this matter is ongoing and we may update or change our opinions as we continue our review and analysis.

APPENDIX 5

COMMENT TO THE DEPARTMENT OF LABOR

**Tax Consequences to Investors Resulting from Proposed Rules
Relating to Financial Representative Fiduciary Status**

**COMPASS LEXECON
JULY 20, 2015**

I. BACKGROUND AND SUMMARY OF OPINIONS

1. The Department of Labor (“DOL”) has proposed amendments to the existing rule that defines when financial representatives are fiduciaries for purposes of ERISA and the Internal Revenue Code, including with respect to advice provided regarding IRA assets.¹ We understand that much or all of the assistance currently provided to investors through commission-based accounts is not currently subject to fiduciary status, but arguably would be so under the proposed amendments.

2. We understand participants in this rulemaking have stated that, if subjected to the changes in fiduciary status imposed by the proposed amendments, firms currently offering commission-based IRAs will no longer find it cost-effective to offer IRAs to small account holders, such as those with a balance below \$25,000. The impact on IRAs is particularly problematic because the IRS strictly limits annual deductions for IRA contributions. For instance, in 2015, total contributions to all traditional and Roth IRAs cannot be more than \$5,500 (or \$6,500 for those 50 or older).² As a consequence, there would be essentially no way for an investor to start a new IRA with one of these firms, unless the investor already had more than \$25,000 in another retirement account that could be “rolled over.”³

3. We understand that the proposed amendments will only affect tax-qualified accounts such as IRAs and Roth IRAs; the proposed amendments will not change firms’ ability to offer commission-based taxable accounts. Obviously, taxable savings accounts lack the tax

1. 80 FR 21927 (April 20, 2015).

2. Internal Revenue Service, Publication 590-A (2014).

3. Making the maximum \$5,500 contributions, and earning 10 percent returns per year, it would take four years before a new IRA account achieved a \$25,000 balance. $\sum_{t=1}^4 5,500(1.07)^t = \$26,129$. A “rollover” is a withdrawal from an existing retirement plan (such as a 401(k) or another IRA) that is reinvested within 60 days into an IRA. If reinvested into a traditional IRA, the rollover amount will generally not be taxed, although it will incur taxes at the time of retirement. Internal Revenue Service, “Rollovers of Retirement Plan and IRA Distributions,” <http://www.irs.gov/Retirement-Plans/Plan-Participant,-Employee/Rollovers-of-Retirement-Plan-and-IRA-Distributions> [accessed July 13, 2015].

advantages of IRAs. Therefore, if, as a consequence of the DOL's proposed amendments, an investor who would have opened an IRA instead opens a taxable savings account, the investor will experience lower retirement savings, all else equal.

4. Compass Lexecon was asked by counsel for Primerica, Inc. ("Primerica") to analyze and quantify these reductions in retirement savings.⁴ The size of the reductions varies depending on a number of factors about an investor and his or her investment choices, such as the length of time the account is held and the investor's income (and hence, his or her tax rate). As a consequence, for this study, we considered a range of possible values for these parameters.

5. Nevertheless, as a general matter, we conclude that, for most investors, the loss associated with opening a taxable savings account instead of an IRA would be large. For example, consider a 30-year-old investor who starts a new IRA, expects to hold it 35 years until retirement, and contributes 4.5 percent of his income annually. The median outcome of our model for this investor involves an effective average tax rate on savings (relative to a totally untaxed account) of 23.8 percent for a Roth IRA and 15.0 percent for a traditional IRA, whereas the effective average tax rate on savings for the same investor making the same investment, but in a taxable savings account, is 38.7 percent. In other words, the taxpayer in this case would see his effective tax rate rise by 62.6 percent relative to a Roth IRA, and 158.0 percent relative to a traditional IRA if the DOL's proposed amendments caused him to open a taxable savings account.

6. The median effective tax increase due to the DOL's proposed amendments varies across investors who start saving at different ages, but in any case, the tax increases remain very substantial, with the median never below 32.9 percent. Therefore, to the extent that the DOL's

4. Appendix A includes a brief description of Compass Lexecon. Appendix B includes a list of materials relied upon in the preparation of this comment.

proposed amendments lead a substantial number of investors to open taxable savings accounts instead of IRAs, the amendments would in essence constitute a sizable tax increase on many Americans' retirement savings.

7. To put these effective tax increases into perspective, we estimated their effect on the number of years of retirement an investor can fund at a desired level of annual retirement income. As an example, consider again the 30-year-old new IRA investor described above who can fund annual retirement income equal to 60 percent of his expected final pre-retirement income. We estimate that the effective tax increase to this investor from opening a taxable account reduces the number of retirement years funded at this level by about 2.7 years or 4.3 years, relative to if he had opened a Roth IRA or a traditional IRA, respectively. For someone who expects 20 total retirement years, these reductions reflect between a 13.5 percent (Roth IRA) and 21.4 percent (traditional IRA) reduction in financially-secure retirement years.

8. These examples above are illustrative, but this type of effective tax increase potentially affects any future investor who seeks to start an IRA with a commission-based professional through contributions or through a relatively small rollover. Available evidence indicates that there are around 7.0 million existing households with these types of IRAs. If 7.0 million future households experience the effective tax increases we estimate in our model, the total reduction in retirement savings would be between \$147 billion and \$372 billion. This is a rough estimate of the potential impact, and, to the extent some investors do not switch to taxable accounts as a consequence of the proposed amendments, the actual impact may be lower. But in any case, this calculation illustrates that the proposed amendments may have very substantial costs which nevertheless do not appear to have been considered in the DOL's cost-benefit study.

9. For our model, we considered investors with typical values of key parameters, such as income and asset allocations. Section II below describes in detail the assumptions about these and other parameters.

10. Section III describes in detail how the model was run. In brief, the model calculates effective tax rates for three different possible savings vehicles: a traditional IRA, a Roth IRA, and a taxable savings account, based on the after-tax value of each at the time of retirement, relative to the value of a hypothetical fully untaxed account. The three types of accounts are assumed to include the same assets, which provide the same fundamental returns; nevertheless, the three types of accounts grow at different rates due to different tax treatments.

11. Future returns to IRA assets are obviously not known in advance. To estimate effective tax rates, we perform what is known as a “Monte Carlo” model. First, we draw a set of returns at random for each year until retirement based on the historical distribution of returns to different types of assets. We then calculate the resulting effective tax rates for each type of account based on the results of the model using these randomly-drawn returns. We then repeat the entire process 10,000 times. This allows us to report the median effective tax rates, as well as other statistics, such as the 95th percentile.

12. Section IV reports the resulting effective tax rates and the potential tax impacts of the DOL’s proposed amendments for investors starting accounts at various ages and with various income levels. Section IV also describes in more detail the calculations noted above regarding the effect on the number of secure retirement years and the total potential tax impact on U.S. investors.

II. DESCRIPTION OF MODEL

13. We first describe the key parameters of the model, including the investor's age, income, tax rates, annual size and frequency of contributions to savings, and asset allocations. We then describe how investment returns are calculated each year.

A. Investor Characteristics

14. We considered an investor who plans to retire at age 65. In order to understand the impact of the DOL's proposed amendments on different types of investors, we considered investors who begin a new retirement savings account today at ages ranging between 30 and 45.

15. Available evidence indicates that IRA investors have somewhat higher income than the average household. According to a recent large survey, the median household income of a household that contributed to an IRA in 2013 was \$87,500 for traditional IRAs, and \$95,000 for Roth IRAs.⁵ An average of these two is \$91,250. The same survey indicates a median age of 45 years for a household head contributing to an IRA.⁶ By contrast, U.S. Census data indicates that in 2013, median household income for a household with a 45-year-old head-of-household was \$66,057.⁷ Therefore, the typical IRA-contributing household has an income level approximately 38 percent higher than the median U.S. household of the same age.⁸

16. For our model, we assumed that a typical investor's household income when starting an IRA would be approximately 38 percent above the median U.S. household income for

5. Sarah Holden and Daniel Schrass (2015) "Appendix: Additional Data on IRA Ownership in 2014," *ICI Research Perspective* 21(1A), at 11.

6. The median age of the household solo or co-decisionmaker for saving and investing was 47 years for a traditional IRA and 43 years for a Roth IRA. *Id.*, at 11.

7. Median household income for a household with a 35-44 year-old head-of-household was \$64,973, and the similar figure for households with a 45-54 year-old head-of-household was \$67,141. \$66,057 is the average of these two figures. U.S. Census Historical Income Table H.10, <http://www.census.gov/hhes/www/income/data/historical/household/index.html> [accessed July 7, 2015].

8. $\$91,250 / \$66,057 = 1.38$.

individuals of the same age. For example, at age 30, household income of \$72,729 is 38 percent above the median household income,⁹ and at age 45, \$91,159 is 38 percent above the median.¹⁰ In 2011, these incomes would correspond to approximately the 70th percentile of U.S. household income for each age.¹¹

17. We also allow the investor's income to increase over the period of the investment in the model. This happens for three reasons. First, incomes rise with age due to increased human capital accumulation and other effects. The U.S. Census data on household income described above indicates an average 1.3 percent higher household income per year of age in 2013.¹² Second, our model is based on nominal dollars, and there is likely to be at least a moderate amount of inflation in the future. The most recent long-term forecast for annual growth in inflation from the Philadelphia Federal Reserve's "Survey of Professional Forecasters" is 2.14 percent.¹³ Third, median household incomes have historically grown faster than inflation. Between 1980 and 2013, median real household income for all U.S. households experienced a compound annual growth rate of 0.26 percent in constant dollars.¹⁴ Combining these three effects, we assumed annual income growth for the investor of 3.70 percent until retirement at age 65 (= 1.30 percent + 2.14 percent + 0.26 percent).

9. In 2013, median household income for households with head-of-household aged 24-34 years was \$52,702. *Id.* \$72,729 = \$52,702 x 1.38.

10. In 2013, median household incomes for households with head-of-household aged 35-44 years and 45-54 years were \$64,973 and \$67,141, respectively. *Id.* \$91,159 = (((\$64,973 + \$67,141) / 2) x 1.38).

11. U.S. Census Bureau, 2011 Annual Social and Economic (ASEC) Supplement, HINC-02, Total All Races, http://www.census.gov/hhes/www/cpstables/032012/hhinc/hinc02_000.htm [accessed July 17, 2015].

12. Median household income for households with head-of-household aged 15-24 was \$34,311, and the similar figure for households with head-of-household aged 55-64 was \$57,538. U.S. Census Historical Income Table H.10, *op. cit.* 1.30 percent = $(57,538 / 34,311)^{(1/(59.5 - 19.5))} - 1$.

13. <https://www.philadelphiafed.org/research-and-data/real-time-center/survey-of-professional-forecasters/2015/survq215> [accessed July 7, 2015].

14. In 2013 dollars, median household income was \$51,939 in 2013, and \$47,668 in 1980. U.S. Census Historical Income Table H.10, *op. cit.* 0.26 percent = $(51,939 / 47,668)^{(1/(2013 - 1980))} - 1$.

18. Upon retirement, we assumed a reduction in income of 40 percent, relative to income in the prior year (in other words, an income replacement rate of 60 percent). This is consistent with findings in the academic literature,¹⁵ as well as recent data from the Social Security Administration.¹⁶

19. Federal income tax rates ranging between 10 percent and 39.6 percent were applied in each year based on the current marginal tax rates applicable to a married jointly-filing household with taxable income calculated as described above. The threshold incomes defining each income tax bracket are assumed to increase annually by 2.14 percent from their current (2015) levels based on the long-term forecasts published by the Philadelphia Federal Reserve described above. The current capital gains tax rates that correspond to each income tax bracket are assumed to maintain that same relationship in the future.¹⁷ For investors with income above \$250,000, the recently implemented Net Investment Income Tax of 3.8 percent was also applied.¹⁸

20. As noted above, the median household income of an investor contributing to a traditional IRA is \$87,500, and the median age of the head-of-household for traditional IRA contributors is 47.¹⁹ The average annual contribution to a traditional IRA for a contributing

15. See, e.g., B. Douglas Bernheim, Jonathan Skinner, and Steven Weinberg (1997) “What Accounts for the Variation in Retirement Wealth Among U.S. Households?” NBER Working Paper 6227, at 53 (indicating median income replacement rate of 0.60).

16. Andrew G. Biggs and Glenn R. Springstead (2008) “Alternate Measures of Replacement Rates for Social Security Benefits and Retirement Income,” *Social Security Bulletin* 68(2), at Table 3 (indicating replacement rate relative to final earnings of 69 percent for households in the 3rd highest quintile, and 52 percent for households in the 4th highest quintile).

17. For taxpayers in the 10 or 15 percent income tax bracket, the capital gains tax rate is 0 percent. For taxpayers in the 25, 28, 33, or 35 percent income tax bracket, the capital gains tax rate is 15 percent. For taxpayers in the 39.6 percent income tax bracket, the capital gains tax rate is 20 percent. Internal Revenue Service, “Publication 17 (2014),” at Chapter 16.

18. By law, the \$250,000 threshold is not adjusted for inflation. See <http://www.irs.gov/uac/Newsroom/Net-Investment-Income-Tax-FAQs> [accessed July 10, 2015].

19. Holden and Schrass (2015) *op. cit.*

household with head-of-household between 45 and 49 is \$3,975.²⁰ This therefore corresponds to approximately 4.5 percent of household income. Hence, we assume that investors make a contribution to retirement savings equal to 4.5 percent of income (on a pre-tax basis), unless the contribution is limited, as described below. (Of course, investors may contribute additional amounts to other forms of retirement savings outside our model, such as company plans.)

21. Current contribution limits to an IRA are \$5,500 per year (\$6,500 for investors age 50 or above).²¹ By statute, these limits increase according to a formula relating to the inflation rate, and we applied this formula to project contribution limits in each year over the period of investment until retirement.²² If an investor's contribution of 4.5 percent of income exceeds these limits in any year, we assumed the investor contributed only the limited amount. In order to maintain comparability, we assumed the same limited contribution, whether the investment was made in an IRA or a taxable savings account.

22. Available evidence indicates that many investors who own IRA accounts nevertheless do not contribute to them every year.²³ Therefore, in our model we considered two possibilities for the investor: (a) contribute the amount described above every year, or (b) contribute the amount described above every other year.

20. Craig Copeland (2014) "Individual Retirement Account Balances, Contributions, and Rollovers, 2013; With Longitudinal Results 2010-2013: The EBRI IRA Database," Employee Benefit Research Institute Issue Brief 414, at 17 (Figure 16).

21. Internal Revenue Service, "Retirement Topics – IRA Contribution Limits," <http://www.irs.gov/Retirement-Plans/Plan-Participant,-Employee/Retirement-Topics-IRA-Contribution-Limits> [accessed July 7, 2015].

22. The contribution limit for investors under age 50 is calculated as \$5,000, multiplied by the ratio of the CPI for the relevant year and the CPI for 2007. 26 USC §§219(b)(D) & 1(f)(3). The contribution limit for investors age 50 and above is \$1,000 higher than the limit for younger investors. 26 USC §§219(b)(B).

23. Craig Copeland (2014) "Individual Retirement Account Balances, Contributions, and Rollovers, 2013; With Longitudinal Results 2010-2013: The EBRI IRA Database," Employee Benefit Research Institute Issue Brief 414, at 1.

23. A recent survey indicates the typical asset allocation held in IRAs, by the age of the account owner.²⁴ While essentially any asset can be held in an IRA, the bulk of assets are equities, bonds, and money / cash.²⁵ For instance, the typical IRA held by a 25-44 year-old contained 66.3 percent equity, 12.9 percent bonds, 13.9 percent money, and 6.9 percent other assets. For each age group, we allocated the “other” assets evenly across the equity, bonds, and money categories, and then linearly extrapolated these asset allocations reported for age groups to individual ages. We assume that the investor holds these age-specific allocations in their retirement savings, rebalancing annually.²⁶

B. Investment Returns

24. For each year until retirement, the model requires a set of four investment returns: (a) equity appreciation; (b) dividends; (c) bond interest; and (d) bond appreciation. As proxies for the equity appreciation and dividend returns, we calculated these returns for the S&P500 over the past 38 years.²⁷ As proxies for the bond yield and appreciation, we calculated these returns for the Barclay’s U.S. Aggregate Bond Index, also over the past 38 years.²⁸ These returns are gross of commissions paid to brokers or other fees, which will vary depending on the specific asset an investor purchases, but because these commissions and fees would be paid in either an

24. Craig Copeland (2014) “IRA Asset Allocation, 2012, and Longitudinal Results, 2010 – 2012,” *Employee Benefit Research Institute Notes* 35(10), at 8.

25. Other assets account for between 5.7 and 11.1 percent of assets, depending on the age of the account holder. *Id.*

26. Given the assumed annual contributions, as well as dividend, interest, and capital gains distributions (as described below), we assumed this rebalancing could be made without selling any current holdings (and thus potentially triggering capital gains tax liability).

27. Both returns are calculated, assuming reinvestment (of capital gains or dividends, respectively). The mean annual S&P total return (including price appreciation and dividends) over this period is 12.6 percent, with a 16.7 percent standard deviation. The mean annual dividend return over this period is 2.8 percent, with a 1.3 percent standard deviation.

28. The mean annual Barclay’s Aggregate Bond Index total return (including coupons and price appreciation) over this period is 7.9 percent, with a 6.9 percent standard deviation. The mean annual coupon return over this period is 7.4 percent, with a 3.1 percent standard deviation.

IRA or a taxable savings account, a comparison of the value of the two accounts will likely not suffer a material bias due to this omission.

25. For each year until retirement in our model, we selected at random (with replacement) one year from the past 38 years, and applied the four historical returns from that selected year. Given the asset allocation described above, we can, for each year until retirement, calculate the gain in the value of the account. We assume that all dividends and interest are reinvested in the account. We also assume that a share of the equity portion of the portfolio is distributed each year as (long-term) realized capital gains, but then reinvested. Over the last five years, the three largest U.S. load-bearing equity-only mutual funds distributed an average of 2.2 percent of fund value as long-term capital gains,²⁹ so we assume 2.2 percent of the equity held in the account is distributed as realized capital gains each year (and then reinvested).

III. MODEL OPERATION

26. At the beginning of each year, the investor makes her annual contribution and draws a set of equity and bond returns, as described above. For a taxable savings account or a Roth IRA, the annual contribution is made using after-tax dollars (*i.e.*, the contribution is reduced by the contemporaneous marginal tax rate), while for a traditional IRA, the annual contribution is made using pre-tax dollars.³⁰ The portfolio then grows during the year according to the returns drawn, and at the end of the year, the investor pays any taxes due before the start of the next year. In the case of IRAs, no taxes are paid at the end of each year. In the case of a

29. According to Morningstar, the three largest equity-only load-bearing mutual funds are AGTHX, AIVSX, and CWGIX. The calculation was performed over the years 2010 – 2014. None of these funds distributed short-term capital gains in any of these years.

30. In the case of a traditional IRA, the deduction that allows the contribution to be made in pre-tax dollars may not be realized until the end of the year, but we assume the deduction is available at the beginning of the year.

taxable savings account, ordinary income taxes are paid each year on interest and dividends received that year, and long-term capital gains taxes are paid on capital gains distributions. After taxes, the remaining interest, dividends, and capital gains are reinvested in the account.³¹

27. At age 65, the investor retires and we value the account at that point. For a Roth IRA, no taxes are due on withdrawal. For a traditional IRA, taxes are paid on the full amount of the account at the point of retirement, based on the marginal income tax rate applicable in retirement, calculated as described above (40 percent below the last working year income). For a taxable savings account, taxes are paid at retirement on the gain in the account, relative to the cost basis, based on the long-term capital gains tax rate applicable in retirement, calculated as described above. The cost basis each year is calculated as the annual contributions made to the account, plus reinvested interest, dividends, and realized capital gains (net of taxes). The cost basis at retirement is the sum of the cost basis calculated each year.

28. The values at retirement of the various accounts, and hence, the effective tax rates, depend on the investment returns experienced each year. As noted above, these are a random draw from historical returns. Hence, the results will differ in any given run of the model. We ran a Monte Carlo simulation of the model with 10,000 iterations.³²

31. We do not allow for loss “harvesting” in the case of a taxable savings account, in which investors strategically realize capital losses on certain assets to offset any gains they may have. Some evidence indicates that such harvesting can, if performed rigorously, increase the value of a portfolio materially. Robert D. Arnott, Andrew L. Berkin, and Jia Ye (2001) “Loss Harvesting: What’s It Worth to the Taxable Investor?” *First Quadrant Perspective*, No. 1, at 13 (“We have simulated returns for 500 assets over 25 years to examine the benefits of loss harvesting for taxable portfolios ... Even after liquidation, net of all deferred taxes, this advantage is still an impressive 14%.”) However, available evidence indicates that few investors actually realize gains through such a strategy. Brad M. Barber and Terrance Odean (2003) “Are individual investors tax savvy? Evidence from retail and discount brokerage accounts,” *Journal of Public Economics* 88:419-42, at 440 (“both discount and retail households have a strong preference for realizing gains, rather than losses, in their taxable accounts.”)

32. See William H. Greene (2012) *Econometric Analysis* (7th ed.), Prentice Hall, at 615-7. Ten thousand iterations is relatively large compared with other Monte Carlo studies of tax behavior. See, e.g., Robert D. Arnott, Andrew L. Berkin, and Jia Ye (2001) *op. cit.*, at 6 (indicating 500 simulations).

IV. RESULTS

A. Effective Tax Rates

29. Exhibit A summarizes the results of eight specifications of the model, corresponding to different ages at account inception and different contribution frequencies. The results of each specification are based on a separate set of 10,000 runs of the model. In the first specification, an investor who starts contributing at age 30 makes a contribution to the account every year. In the second model, the same investor makes a contribution only every other year. The remaining specifications increase the investor's age at account inception in five-year increments up to age 45. In each specification, we report the after-tax value at retirement of four types of accounts that differ only in their tax treatment: a completely untaxed account (for reference), a traditional IRA, a Roth IRA, and a taxable savings account. We report the median value for each of these (across all 10,000 runs), as well as the 5th and 95th percentiles.

30. For an investor who begins an account at age 30 and contributes every year, the median traditional IRA at retirement after taxes is worth \$1,021,747, with a 5th to 95th percentile range of \$498,220 to \$2,102,672 (these figures are in nominal 2050 dollars, when the investor in question retires). The median Roth IRA is worth \$916,524, with a 5th to 95th percentile range of \$444,695 to \$1,891,507. The median taxable savings account is worth \$736,068, with a 5th to 95th percentile range of \$364,754 to \$1,495,796. This demonstrates the substantial tax savings generated by IRAs, relative to taxable savings accounts. Unsurprisingly, Exhibit A also shows that all account values diminish substantially for investors who either wait until later ages to begin an account or who do not contribute every year; nevertheless, IRAs still have substantial tax benefits in all cases. (In part, the decline in value for investors who start accounts at later ages is due to the fact that the account values are calculated in nominal dollars at the time of

retirement. Thus, the results for a 45-year-old investor are denominated in nominal 2035 dollars, whereas the results for a 30-year-old investor are denominated in nominal 2050 dollars.)

31. We also report in Exhibit A the median, 5th, and 95th percentiles of the effective tax rates on each of the IRAs and the taxable savings account. The effective tax rate is calculated separately in each of the 10,000 runs of the model, based on the difference between the value of the IRA or taxable savings account, and the value of the completely untaxed account. For instance, if in a particular run, a completely untaxed account would be worth \$500,000 in retirement, and an otherwise equivalent taxable savings account is only worth \$350,000, then the effective tax rate is 30 percent ($= \$150,000 / \$500,000$). (The median, 5th, and 95th percentile tax rate may not correspond to the same run of the model as the median, 5th, and 95th percentile account value; hence, the tax rates in Exhibit A cannot necessarily be calculated directly using the account values reported in Exhibit A.)

32. For an investor who begins an account at age 30 and invests every year, the median effective tax rate for a traditional IRA is 15.0 percent, a Roth IRA is 23.8 percent, and a taxable savings account is 38.7 percent. The traditional IRA tax rate is based entirely on the tax bracket at retirement, while the Roth IRA tax rate reflects the various tax brackets throughout the working life. If the investor is in the same tax bracket at retirement as throughout his working life, then a Roth IRA and a traditional IRA have the same value at retirement. If the investor is in a lower tax bracket in retirement than during the working life, then the traditional IRA will have a higher value at retirement than a Roth IRA, and vice-versa if the investor is in a higher tax bracket at retirement. For the taxable account, taxes are paid both during the working life and at retirement, so the effective tax rate we calculate reflects both.

33. While contributing only every other year substantially diminishes the value of any account at retirement, it has little impact on the effective tax rates. The age at which the investor

begins contributing can affect the effective tax rates on each type of account. This reflects investors' movements between various tax brackets during the working life and at retirement. Investors' incomes rise over time, but the tax bracket thresholds also rise, although at a different rate. For this reason, investors of different ages today may end up retiring in different tax brackets.

34. Exhibit A also reports the lost retirement savings for an investor who opens a taxable savings account instead of an IRA. For an investor who begins an account at age 30 and contributes every year, the median loss is \$179,541 relative to a Roth IRA, and \$286,046 relative to a traditional IRA (again, these figures are in nominal 2050 dollars). The loss is so much larger for a traditional IRA because, in foregoing a traditional IRA, the investor in this case loses the advantage granted by his lower tax bracket in retirement. However, that additional advantage of traditional IRAs does not apply to all investors of different ages in our model, because, even assuming retirement income is 60 percent of pre-retirement income, some investors may nevertheless end up retiring in the same tax bracket as they spent most or all of their working life. In addition, starting to save at a later age (or contributing only every other year) reduces the loss from opening a taxable savings account instead of an IRA simply because the accounts are worth less.

35. The last statistic in Exhibit A is the effective tax increase in percent imposed by placing IRA investors into taxable savings accounts. For instance, if, in a particular run of the model, the effective tax rate on an IRA is 25 percent, and the effective tax rate on a taxable savings account is 35 percent, then the effective tax increase on retirement savings is 40 percent ($= 10 \text{ percent} / 25 \text{ percent}$). For an investor who begins an account at age 30 and contributes every year, the median effective tax increase in moving from a Roth IRA to a taxable account is 62.6 percent; the equivalent figure for a traditional IRA is 158.0 percent. Again, the tax increase

imposed on a traditional IRA holder is larger because, in addition to the tax benefits of IRAs generally, the investor also loses the benefit of paying taxes at the lower rate applicable during retirement. The 5th-to-95th percentile of the tax rate increase is 52.6 percent to 72.0 percent for the Roth IRA, and 145.8 percent to 169.1 percent for the traditional IRA, indicating that in all or nearly all cases, the investor would be expected to suffer a substantial tax increase.

36. Contributing only every other year has little effect on these effective tax increase estimates. The effective tax increases do depend to some degree on the age at which the investor begins the accounts, but the median tax increase is never less than 32.9 percent at any age, and even at the 5th percentile, the tax increases for investors of different ages are at or above 28 percent. Hence, investors of all types are very likely to experience a substantial tax increase if, as a consequence of the DOL's proposed amendments, they open taxable accounts instead of IRAs.

37. One factor not incorporated into our model is the penalty for early withdrawal imposed on IRAs. Investors always face the temptation to raid retirement savings in response to financial shocks and other needs.³³ For IRAs, the law imposes a 10 percent additional tax on early distributions from both traditional and Roth IRAs in most cases.³⁴ No such additional tax applies to taxable accounts. This difference in incentives may make it more likely that investors maintain their savings in IRAs, relative to taxable accounts. If so, then the difference in account balances between IRAs and taxable accounts at the time of retirement will be even larger than we estimate in our model.

33. Gene Amromin and Paul Smith (2003) "What Explains Early Withdrawals from Retirement Accounts? Evidence from a Panel of Taxpayers," *National Tax Journal* 56(3):595-612.

34. Internal Revenue Service, "Topic 557," <http://www.irs.gov/taxtopics/tc557.html> [accessed July 15, 2015].

38. While, as noted above, the typical IRA investor has household income higher than the U.S. median, IRAs are nevertheless popular investments for households of all income levels. In order to better understand the effects of placing IRA investors into taxable savings accounts, we therefore also ran variants of the model, assuming different household income levels for the investor. For illustrative purposes, we focused on the specification of the model in which the investor begins an account at age 30 and contributes every year. As discussed above, we estimate the median household income of such an investor at age 30 as \$72,729. In Exhibit B, we also ran the model assuming the investor's household income at age 30 was either higher or lower than this value by 10 percent or 25 percent, producing a range between \$54,547 and \$90,911. In 2011, this range of household incomes would encompass approximately the 54th percentile up to the 80th percentile of the distribution of the household incomes of 30-year-olds in the U.S.³⁵

39. As in Exhibit A, we report in Exhibit B the median, 5th, and 95th percentiles of account values, effective tax rates, lost retirement income, and effective tax increases when opening a taxable savings account instead of an IRA. Exhibit B shows that higher income households have higher account values at retirement, since they are able to contribute more to their accounts each year. Effective tax rates on all accounts also generally rise with income, consistent with the progressive tax structure. Placing higher income IRA investors into taxable savings accounts sometimes involves larger tax increases and sometimes involves lower tax increases, relative to lower income investors, due to the different tax brackets during the working career and retirement for households of different incomes. At all income levels considered, however, the median tax increase for an investor who would have opened a Roth IRA but instead

35. U.S. Census Bureau, 2011 Annual Social and Economic (ASEC) Supplement, HINC-02, Total All Races.

opens a taxable account is greater than 62 percent, and the median tax increase for an investor who would have opened a traditional IRA but instead opens a taxable account is greater than 73 percent. Thus, investors with a wide range of incomes would experience substantial losses if the DOL's proposed amendments reduced their access to IRAs.

B. Implications for Retirement Security

40. The effective tax increases calculated above are clearly substantial, but in order to make these results concrete, we examined the impact these tax increases would have on investors' retirement security. To illustrate, we considered the effect for investors initiating accounts at age 30, as described above, and contributing annually throughout the working life. Immediately before retirement (*i.e.*, in 2049, at age 64), the investor's household income is \$250,141 (in nominal 2049 dollars, not current dollars). As noted above, the typical retirement income replacement rate, relative to pre-retirement income, is about 60 percent, so suppose this investor was able to maintain retirement income at about \$150,085 (again, in nominal 2049 dollars).³⁶

41. In Appendix C, we use the Social Security Administration's benefit formula to project the annual Social Security payment this investor would receive at the time of retirement in 2050 as \$83,291. This means that the investor's savings must cover the remaining \$66,794 each year.³⁷ In Exhibit A above, we estimated median account values at retirement for the investor of \$916,524 for a Roth IRA, \$1,021,747 for a traditional IRA, and \$736,068 for a taxable savings account. Of course, investors may also have other assets that they can use to fund their retirement, but these figures indicate that an investor can fund her retirement at the

36. $\$150,085 = \$250,141 \times 60 \text{ percent.}$

37. $\$66,794 = \$150,085 - \$83,291.$

desired level for approximately 13.7 years with a Roth IRA, 15.3 years with a traditional IRA, and 11.0 years with a taxable savings account.³⁸

42. This means that if, as a consequence of the DOL's proposed amendments, an investor opens a taxable savings account instead of an IRA, they would lose approximately 2.7 years of fully-funded retirement based on a Roth IRA, and approximately 4.3 years based on a traditional IRA. For an investor who expects roughly 20 years of retirement, this reflects a 13.5 percent or 21.4 percent reduction in fully-funded retirement, respectively.

C. Aggregate Tax Increase Estimates

43. Finally, we also estimated the potential overall dollar impact to U.S. investors from the effective tax increases calculated above. Our calculation necessarily is a rough estimate, and relies on several assumptions for which there is some uncertainty. The actual impact may be larger or smaller than we calculate here. Nevertheless, this illustrates that the total impact may be very large if investors open taxable accounts instead of IRAs as a consequence of the proposed amendments. It must therefore be seriously considered in any reasonable cost-benefit analysis of the proposed amendments.

44. The DOL has indicated that in 2013, 34 million U.S. households had IRAs, and 41 percent of IRA-owning households reported holding IRAs at brokerages.³⁹ This implies there are approximately 14.0 million U.S. households with brokerage IRAs. As noted above, we understand that, as a consequence of the proposed amendments, many of the firms offering these

38. We ignore additional investment returns after retirement for these calculations. This is appropriate if investors switch to less risky assets that provide expected returns that do not exceed inflation by much. If investors are able to maintain returns above inflation during retirement, then these accounts can fund more years of retirement at the desired level, and the differences between the accounts in the number of years funded will be higher. This is one reason why the results presented here may be conservative.

39. Department of Labor (2015) "Fiduciary Investment Advice: Regulatory Impact Analysis," at 52 & 53.

accounts have indicated they will restrict the availability of new IRAs with balances less than \$25,000. Therefore, the proposed amendments have the potential to affect all households that (absent the amendments) would have started brokerage IRAs either from a contribution or a rollover of less than \$25,000.

45. The DOL has claimed that approximately half of all existing IRAs include no rollover funds.⁴⁰ Moreover, many IRAs initiated with rollover funds were likely started with less than \$25,000. Indeed, the median traditional IRA rollover amount was only \$22,840 in 2012.⁴¹ To be conservative, we assume that only half of the 14.0 million U.S. households with brokerage IRAs started those accounts with a contribution or a rollover less than \$25,000.

46. Available data indicates that the average value (in 2013 dollars) of an IRA held by a 65-year-old investor is \$188,976.⁴² This reflects all IRAs, not only brokerage IRAs, but we are not aware of any available data providing information on average balances at age 65 among only brokerage IRAs. If the average balance for the 7.0 million households calculated above was \$188,976 (in 2013 dollars) at the time these households retire, then these accounts would be worth, in total, \$1,323 billion upon retirement.

47. We do not know whether the proposed amendments will affect these 7.0 million households who hold existing IRAs, but even if their access to existing IRAs is not affected, these households will, over time, be replaced with new households who may be affected if their ability to start new IRAs is impaired. The median results of the model for all ages of investors (as reported in Exhibit A) indicate that, at the time of retirement, taxable saving accounts have a

40. *Id.*, at 54.

41. Investment Company Institute (2014) “The IRA Investor Profile: Traditional IRA Investors’ Activity, 2007 - 2012,” at 36.

42. Craig Copeland (2014) “Individual Retirement Account Balances, Contributions, and Rollovers, 2013; With Longitudinal Results 2010-2013: The EBRI IRA Database,” Employee Benefit Research Institute Issue Brief 414, at 9 (indicating average IRA balance of \$165,139 for individuals 60-64 and \$212,812 for individuals 65-70; the average of these two figures is \$188,976).

value that is between 11.1 percent and 21.9 percent lower than Roth IRAs, and between 18.2 percent and 28.1 percent lower than traditional IRAs. This provides a range of the potential effect on savings at the time of retirement if investors forego IRAs for taxable accounts.

48. Applying this range to the estimated \$1,323 billion in IRA savings at the time of retirement for 7.0 million future households similar to those existing today, the potential investor losses due to a regulation that moves these households into taxable accounts would be between 147 billion and 372 billion.

49. These losses would be spread out over many years, of course, as some of the 7.0 million households in question would likely not retire until well into the future. Moreover, it is possible some of these households could avoid or mitigate the impact of the effective tax increases we calculate by finding other ways to invest in IRAs, such as through non-commission-based accounts or by putting off starting an IRA until a later age when greater rollover assets may be available to them. (Of course, these alternative options may involve costs as well.) Nevertheless, these figures do illustrate that the potential total impact to U.S. savers of any regulation that restricts access to IRAs may be very large and must be at least considered in any reasonable cost-benefit analysis of such a regulation.

Exhibit A

Summary of Model Estimates of Tax Impact of Placing IRA Investors Into Taxable Accounts

Age at Account Inception	Contribution Frequency	Account Value at Retirement (Nominal \$ at Time of Retirement)				Effective Tax Rate on Retirement Savings ²			Lost Retirement Savings From Taxable Acct. ³		Effective Tax Increase From Taxable Acct. ⁴		
		Untaxed ¹	Traditional	Roth IRA	Taxable Account	Traditional IRA	Roth IRA	Taxable Account	Relative to Traditional IRA	Relative to Roth IRA	Relative to Traditional IRA	Relative to Roth IRA	
Median Values (50th Percentile)													
30	Annual	\$1,202,055	\$1,021,747	\$916,524	\$736,068	15.0%	23.8%	38.7%	\$286,046	\$179,541	158.0%	62.6%	
30	Biennial	\$623,203	\$529,723	\$475,040	\$380,843	15.0%	23.8%	38.8%	\$149,021	\$93,930	158.9%	63.0%	
35	Annual	\$816,199	\$612,149	\$612,149	\$480,709	25.0%	25.0%	41.0%	\$131,057	\$131,057	64.0%	64.0%	
35	Biennial	\$418,982	\$314,237	\$314,237	\$245,492	25.0%	25.0%	41.3%	\$68,425	\$68,425	65.3%	65.3%	
40	Annual	\$530,698	\$398,024	\$398,024	\$325,439	25.0%	25.0%	38.7%	\$72,553	\$72,553	54.7%	54.7%	
40	Biennial	\$277,475	\$208,106	\$208,106	\$169,772	25.0%	25.0%	38.8%	\$38,339	\$38,339	55.1%	55.1%	
45	Annual	\$306,697	\$260,693	\$230,023	\$204,503	15.0%	25.0%	33.2%	\$55,907	\$25,202	121.5%	32.9%	
45	Biennial	\$157,224	\$133,640	\$117,918	\$104,386	15.0%	25.0%	33.5%	\$29,197	\$13,433	123.6%	34.2%	
5th Percentile Values (95% of Outcomes Involve Larger Values)													
30	Annual	\$586,141	\$498,220	\$444,695	\$364,754	15.0%	23.3%	36.9%	\$131,965	\$77,816	145.8%	52.6%	
30	Biennial	\$302,958	\$257,514	\$229,727	\$188,380	15.0%	23.3%	37.0%	\$68,584	\$40,494	146.3%	52.9%	
35	Annual	\$418,407	\$313,805	\$313,805	\$265,144	25.0%	25.0%	36.6%	\$48,499	\$48,499	46.5%	46.5%	
35	Biennial	\$211,518	\$158,639	\$158,639	\$133,429	25.0%	25.0%	37.0%	\$25,402	\$25,402	47.9%	47.9%	
40	Annual	\$300,127	\$225,095	\$225,095	\$196,335	25.0%	25.0%	34.6%	\$28,909	\$28,909	38.3%	38.3%	
40	Biennial	\$156,689	\$117,517	\$117,517	\$102,111	25.0%	25.0%	34.6%	\$15,158	\$15,158	38.6%	38.6%	
45	Annual	\$185,452	\$157,635	\$139,089	\$124,898	15.0%	25.0%	32.0%	\$32,883	\$14,066	113.5%	28.1%	
45	Biennial	\$93,845	\$79,768	\$70,384	\$62,662	15.0%	25.0%	32.3%	\$16,863	\$7,424	115.5%	29.3%	
95th Percentile Values (95% of Outcomes Involve Smaller Values)													
30	Annual	\$2,473,732	\$2,102,672	\$1,891,507	\$1,495,796	15.0%	24.3%	40.4%	\$606,129	\$398,323	169.1%	72.0%	
30	Biennial	\$1,289,872	\$1,096,391	\$986,903	\$778,113	15.0%	24.3%	40.5%	\$318,622	\$209,811	170.2%	72.7%	
35	Annual	\$1,534,900	\$1,151,175	\$1,151,175	\$865,575	25.0%	25.0%	43.7%	\$285,561	\$285,561	74.9%	74.9%	
35	Biennial	\$796,981	\$597,736	\$597,736	\$447,234	25.0%	25.0%	44.0%	\$150,603	\$150,603	76.1%	76.1%	
40	Annual	\$927,703	\$695,777	\$695,777	\$546,565	25.0%	25.0%	41.3%	\$151,255	\$151,255	65.3%	65.3%	
40	Biennial	\$488,306	\$366,230	\$366,230	\$285,822	25.0%	25.0%	41.5%	\$80,123	\$80,123	65.9%	65.9%	
45	Annual	\$496,239	\$421,803	\$372,179	\$329,396	15.0%	25.0%	34.5%	\$92,870	\$43,711	130.0%	38.0%	
45	Biennial	\$258,089	\$219,375	\$193,566	\$170,684	15.0%	25.0%	34.8%	\$48,972	\$23,497	132.1%	39.3%	

Note: See text for assumptions regarding income at inception, income growth rate, inflation rate, investment returns, and other parameters.

1. Untaxed account value is reported in order to identify effective tax rates.

2. Effective tax rate is loss in specified account value, relative to untaxed account, at time of retirement. For instance, if an untaxed account would be worth \$1,000,000, and an IRA or taxable account would be worth \$800,000, then the effective tax rate is 20%.

3. Lost retirement savings is difference in dollar value between taxable account and specified IRA account at time of retirement.

4. Effective tax increase is percentage increase in effective tax rate between taxable account and specified IRA. For instance, if the effective tax rate on a taxable account is 35 percent and the effective tax rate on an IRA is 25 percent, then the effective tax increase is 40% ((35% - 25%) / 25%).

Exhibit B
Summary of Model Estimates of Tax Impact of Placing IRA Investors Into Taxable Accounts
30-Year-Old Account Holder Making Annual Contributions
Various Initial Income Levels

Household Income at Age 30	Account Value at Retirement (Nominal \$ at Time of Retirement)				Effective Tax Rate on Retirement Savings ²			Lost Retirement Savings From Taxable Acct. ³		Effective Tax Increase From Taxable Acct. ⁴	
	Traditional		Taxable		Traditional		Taxable	Relative to	Relative to	Relative to	Relative to
	Untaxed ¹	IRA	Roth IRA	Account	IRA	Roth IRA	Account	Traditional IRA	Roth IRA	Traditional IRA	Roth IRA
Median Values (50th Percentile)											
\$54,547	\$901,545	\$766,314	\$748,296	\$631,862	15.0%	17.1%	30.0%	\$135,149	\$116,292	99.8%	75.3%
\$65,456	\$1,081,848	\$919,571	\$861,046	\$698,208	15.0%	20.5%	35.5%	\$222,911	\$162,351	136.6%	72.9%
\$72,729	\$1,202,055	\$1,021,747	\$916,524	\$736,068	15.0%	23.8%	38.7%	\$286,046	\$179,541	158.0%	62.6%
\$80,002	\$1,322,262	\$991,697	\$991,697	\$748,521	25.0%	25.0%	43.4%	\$243,303	\$243,303	73.4%	73.4%
\$90,911	\$1,495,024	\$1,121,268	\$1,126,455	\$847,465	25.0%	24.6%	43.3%	\$273,541	\$279,053	73.1%	75.7%
5th Percentile Values (95% of Outcomes Involve Larger Values)											
\$54,547	\$439,608	\$373,667	\$359,700	\$307,331	15.0%	16.2%	28.6%	\$65,817	\$51,680	91.0%	61.5%
\$65,456	\$527,526	\$448,397	\$413,849	\$341,857	15.0%	19.3%	34.1%	\$105,480	\$70,444	127.5%	58.6%
\$72,729	\$586,141	\$498,220	\$444,695	\$364,754	15.0%	23.3%	36.9%	\$131,965	\$77,816	145.8%	52.6%
\$80,002	\$644,756	\$483,567	\$483,567	\$393,465	25.0%	25.0%	38.9%	\$89,977	\$89,977	55.7%	55.7%
\$90,911	\$725,301	\$543,976	\$549,053	\$445,299	25.0%	24.3%	38.6%	\$98,726	\$103,331	54.3%	58.6%
95th Percentile Values (95% of Outcomes Involve Smaller Values)											
\$54,547	\$1,855,308	\$1,577,011	\$1,550,245	\$1,300,330	15.0%	18.4%	31.3%	\$276,875	\$253,013	108.5%	88.0%
\$65,456	\$2,226,355	\$1,892,402	\$1,788,560	\$1,434,272	15.0%	22.0%	36.9%	\$460,337	\$360,193	145.8%	86.8%
\$72,729	\$2,473,732	\$2,102,672	\$1,891,507	\$1,495,796	15.0%	24.3%	40.4%	\$606,129	\$398,323	169.1%	72.0%
\$80,002	\$2,721,109	\$2,040,831	\$2,040,831	\$1,468,177	25.0%	25.0%	46.1%	\$569,552	\$569,552	84.5%	84.5%
\$90,911	\$3,082,532	\$2,311,899	\$2,318,621	\$1,663,083	25.0%	24.8%	46.2%	\$646,241	\$652,563	84.6%	86.2%

Note: See text for assumptions regarding income at inception, income growth rate, inflation rate, investment returns, and other parameters.

1. Untaxed account value is reported in order to identify effective tax rates.

2. Effective tax rate is loss in specified account value, relative to untaxed account, at time of retirement. For instance, if an untaxed account would be worth \$1,000,000, and an IRA or taxable account would be worth \$800,000, then the effective tax rate is 20%.

3. Lost retirement savings is difference in dollar value between taxable account and specified IRA account at time of retirement.

4. Effective tax increase is percentage increase in effective tax rate between taxable account and specified IRA. For instance, if the effective tax rate on a taxable account is 35 percent and the effective tax rate on an IRA is 25 percent, then the effective tax increase is 40% ((35% - 25%) / 25%).

Appendix A: About Compass Lexecon

Compass Lexecon is an economic consulting firm that specializes in the application of economics to a variety of legal and regulatory issues. Compass Lexecon has a professional staff of more than 325 individuals and fourteen offices throughout the United States, Europe and South America. Compass Lexecon also maintains affiliations with leading academics including several Nobel Prize winners in Economics.

Lexecon, Compass Lexecon's predecessor firm, was founded in 1977 by, among others, then Professor (now Judge) Richard A. Posner of the Seventh Circuit Court of Appeals. Compass Lexecon was formed in January 2008 through the combination of Lexecon with Competition Policy Associates, another premier economic consulting firm. Compass Lexecon is a wholly owned subsidiary of FTI Consulting, Inc., a global business advisory firm. Professor Daniel R. Fischel currently serves as Compass Lexecon's Chairman and President.

Compass Lexecon's practice areas include antitrust, securities and financial markets, intellectual property, accounting, valuation and financial analysis, pension economics and policy, corporate governance, bankruptcy and financial distress, derivatives and structured finance, class certifications and employment matters, damages calculations, business consulting, regulatory investigations and public policy.

Compass Lexecon's clients include the United States Department of Justice and other agencies of the federal government, state and local governments, regulatory bodies, major corporations, investor groups, and leading law firms across the globe.

For more information about Compass Lexecon, see its website at:
www.compasslexecon.com

Appendix B: Materials Relied Upon

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<http://www.ssa.gov/oact/cola/piaformula.html>

Appendix C: Estimated Social Security Payments

1. We estimated the annual Social Security payout for a 30-year-old in 2015 who retires in 2050. As noted above, we assumed household income at age 30 of \$72,729, and increased this income by approximately 4.5 percent per year until age 65.¹ We indexed these earnings to the investor's age 60 year (*i.e.*, 2045, two years before retirement eligibility) according to the Social Security Administration's most recent projections for the National Average Wage Index (NAWI).² These are reported in the table below. The Average Indexed Monthly Earnings (AIME) is the sum of these indexed earnings over the entire 35 year period, divided by 420 months during that period.³ This value is \$18,527.

2. The Primary Insurance Amount (PIA) is calculated as a function of two "bend points" that serve to graduate Social Security benefits for high-income households. These bend points can be calculated based on future values of NAWI, projected as described above, and are reported for each year in the table below. The table indicates that, in the investor's age 62 year (the first year of retirement eligibility), the two bend points are projected to be $B_1 = \$2,876$ and $B_2 = \$17,334$.

3. If B_1 and B_2 are the two bend points, then the PIA is equal to $0.9 \times B_1 + 0.32 \times (B_2 - B_1) + 0.15 \times (AIME - B_2)$.⁴ At age 62, the PIA for this investor is projected to be \$7,394. This value is then increased between ages 62 and 65 at the projected future COLA of 2.7 percent.⁵ A 30-year-old investor today was born in 1985. Therefore, under current regulations,

1. The assumed incomes are always below the Contribution and Benefit Base that constitutes the maximum annual earnings relevant for the calculation of Social Security benefits.

<http://www.ssa.gov/oact/cola/cbbdet.html> [accessed July 17, 2015].

2. <http://www.ssa.gov/oact/TR/TRassum.html> [accessed July 17, 2015]. Earnings after age 60 are not indexed.

3. We assume all of the investor's highest 35 years of earnings take place after age 30.

4. <http://www.ssa.gov/oact/cola/piaformula.html> [accessed July 17, 2015].

5. *Id.*

if this investor retires at age 65, he receives a monthly Social Security benefit equal to 86.67 percent of the COLA-adjusted PIA, or \$6,941. On an annual basis, this is \$83,291.⁶

6. $\$83,291 = \$6,941 \times 12.$

Indexed Earnings and Bend Points for Social Security Benefit Calculation

Year	Age	Assumed Household Income ¹	Projected NAWI Growth Rate ²	Projected NAWI ³	Index Earnings to Age 60 Year ⁴	Projected Bend Point 1 ⁵	Projected Bend Point 2 ⁵
2013	28		1.8%	\$44,888			
2014	29		3.7%	\$46,549			
2015	30	\$72,729	4.9%	\$48,830	\$232,700	\$826	\$4,980
2016	31	\$75,420	5.0%	\$51,271	\$229,818	\$857	\$5,164
2017	32	\$78,211	4.9%	\$53,784	\$227,189	\$899	\$5,418
2018	33	\$81,104	4.7%	\$56,312	\$225,020	\$944	\$5,688
2019	34	\$84,105	4.3%	\$58,733	\$223,725	\$990	\$5,967
2020	35	\$87,217	4.1%	\$61,141	\$222,865	\$1,036	\$6,248
2021	36	\$90,444	4.1%	\$63,648	\$222,009	\$1,081	\$6,516
2022	37	\$93,791	4.0%	\$66,194	\$221,369	\$1,125	\$6,783
2023	38	\$97,261	3.9%	\$68,775	\$220,943	\$1,171	\$7,062
2024	39	\$100,859	3.8%	\$71,389	\$220,730	\$1,218	\$7,344
2025	40	\$104,591	3.8%	\$74,101	\$220,517	\$1,266	\$7,630
2026	41	\$108,461	3.8%	\$76,917	\$220,305	\$1,314	\$7,920
2027	42	\$112,474	3.8%	\$79,840	\$220,092	\$1,364	\$8,221
2028	43	\$116,636	3.8%	\$82,874	\$219,880	\$1,416	\$8,534
2029	44	\$120,951	3.8%	\$86,023	\$219,669	\$1,470	\$8,858
2030	45	\$125,426	3.8%	\$89,292	\$219,457	\$1,525	\$9,195
2031	46	\$130,067	3.8%	\$92,685	\$219,245	\$1,583	\$9,544
2032	47	\$134,880	3.8%	\$96,207	\$219,034	\$1,644	\$9,907
2033	48	\$139,870	3.8%	\$99,863	\$218,823	\$1,706	\$10,283
2034	49	\$145,045	3.8%	\$103,658	\$218,612	\$1,771	\$10,674
2035	50	\$150,412	3.8%	\$107,597	\$218,402	\$1,838	\$11,080
2036	51	\$155,977	3.8%	\$111,686	\$218,191	\$1,908	\$11,501
2037	52	\$161,748	3.8%	\$115,930	\$217,981	\$1,980	\$11,938
2038	53	\$167,733	3.8%	\$120,335	\$217,771	\$2,056	\$12,391
2039	54	\$173,939	3.8%	\$124,908	\$217,561	\$2,134	\$12,862
2040	55	\$180,375	3.8%	\$129,654	\$217,352	\$2,215	\$13,351
2041	56	\$187,049	3.8%	\$134,581	\$217,142	\$2,299	\$13,858
2042	57	\$193,970	3.8%	\$139,695	\$216,933	\$2,386	\$14,385
2043	58	\$201,147	3.8%	\$145,004	\$216,724	\$2,477	\$14,931
2044	59	\$208,589	3.8%	\$150,514	\$216,515	\$2,571	\$15,499
2045	60	\$216,307	3.8%	\$156,233	\$216,307	\$2,669	\$16,088
2046	61	\$224,310	3.8%	\$162,170	\$224,310	\$2,770	\$16,699
2047	62	\$232,610	3.8%	\$168,333	\$232,610	\$2,876	\$17,334
2048	63	\$241,216	3.8%	\$174,729	\$241,216	\$2,985	\$17,992
2049	64	\$250,141	3.8%	\$181,369	\$250,141	\$3,098	\$18,676

1. As described above, income is based on typical IRA investor income at age 30, and increased at approximately 4.5 percent per year.

2. Source: <http://www.ssa.gov/oact/TR/TRassum.html>.

3. Calculated as prior year NAWI, increased at projected growth rate.

4. Calculated as Household Income x (Specified Year NAWI / NAWI in 2045), and equal to Household Income after 2045.

5. Calculated as \$180 x (NAWI from 2 years prior / \$9,779.44). See <http://www.ssa.gov/oact/cola/piaformula.html>.

6. Calculated as \$1,085 x (NAWI from 2 years prior / \$9,779.44). See <http://www.ssa.gov/oact/cola/piaformula.html>.

APPENDIX 6

July 20, 2015

VIA ELECTRONIC MAIL

Office of Regulation and Interpretations
Office of Exemption Determinations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Ave., NW
Washington, DC 20210

Re: Definition of the Term “Fiduciary”; Conflict of Interest Rule—Retirement
Investment Advice (RIN 1210-AB32);
Proposed Best Interest Contract Exemption (ZRIN 1210-ZA25)

To the Office of Regulation and Interpretations:

I write to comment on the rules proposed by the Employee Benefits Security Administration to broaden the definition of “fiduciary” under ERISA and the Internal Revenue Code, and to institute “best interest contract” requirements for financial representatives falling within this new definition. The purpose of this comment is to address certain legal flaws in the rulemakings and proposed rules.

The Department states that “changes in the marketplace” and its “experience” with the current definition of fiduciary have caused it to propose a new regulatory framework for broker-dealers and IRAs. Definition of the Term “Fiduciary”; Conflict of Interest Rule—Retirement Investment Advice, 80 Fed. Reg. 21,928, 21,932 (Apr. 20, 2015) (to be codified at 29 C.F.R. pts. 2509, 2510). The DOL also asserts that broker-dealers labor under conflicts of interest that cause them to act contrary to their client’s interests, which warrants a regulatory response by the Department. *Id.* at 21,934.

The Department’s assertion that “conflicted investment advice” by broker-dealers has resulted in substantial investment underperformance might—if accurate—be reason to call on Congress to enact corrective legislation. Indeed, Congress has already acted in the area by authorizing the Securities and Exchange Commission to establish a fiduciary standard of conduct for brokers and dealers consistent with the standard applicable to investment advisers under the Investment Advisers Act of 1940 (“IAA” or the “Advisers Act”). Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 913(g), 124 Stat. 1376, 1828 (2010). But the Department’s perceptions of broker-dealers

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and investment performance do not empower it to radically rewrite its long-standing definition of “fiduciary investment advice” in a manner that conflicts with ERISA’s plain statutory language, its common law roots, and the framework established by Congress for the regulation of broker-dealers and investment advisers. Nor do the Department’s policy views authorize it to deploy its exemptive authority to construct a whole new regulatory and enforcement regime for IRAs and broker-dealers.

For at least two overarching reasons, therefore, the Department’s expansive new regulatory program is legally flawed.

First, the Department’s proposed interpretation of “fiduciary” is vastly overbroad and impermissible. In enacting ERISA’s fiduciary definition, Congress drew upon principles of trust law and the law governing investment advisers and broker-dealers that must be considered in interpreting the statute today. *See Corning Glass Works v. Brennan*, 417 U.S. 188, 201 (1974); *Blitz v. Donovan*, 740 F.2d 1241, 1245 (D.C. Cir. 1984). Under trust law, a fiduciary relationship arises in the context of a relationship of special “trust and confidence” between the parties. The DOL proposal, however, would deem persons to be fiduciaries where those hallmarks of a fiduciary relationship are absent, for example, when making a recommendation regarding a single transaction. *See* 80 Fed. Reg. at 21,934. Further, ERISA’s reference to “render[ing] investment advice for a fee or other compensation” incorporates terminology in the IAA, which—in accordance with the industry understanding and practice when the IAA was enacted—excludes broker-dealers executing sales from the definition of “investment adviser.” That is because the payment to broker-dealers is principally for the product acquired or sold, not the advice. That limitation is incorporated in ERISA: The phrase “render[ing] investment advice for a fee” by its terms means that the payment is principally made for the investment advice provided, and not for execution of a financial transaction or the sale of a financial product.

Second, the Department lacks the authority to establish new standards and a regulatory and enforcement program for broker-dealers. In the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank”), Congress committed the authority to establish uniform fiduciary duty standards for broker-dealers and investment advisers to the SEC—the agency that has long held principal regulatory responsibility in that area—and only after the Commission completed a study on the effects of any such standards. DOL may not front-run the Commission by crafting its own new standards and enforcement program, and certainly may not do so by bootstrapping its authority to interpret “fiduciary” into a sweeping new regulatory program replete with private rights of action and mandatory class actions.

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DISCUSSION

I. The Department's Definition Of "Fiduciary" Is Vastly Overbroad And Impermissible.

The Department has proposed a definition of "fiduciary" so broad that it must be accompanied by seven carve-outs and six prohibited transaction exemptions to limit the scope of even a small portion of the vast new regulatory regime it would establish over broker-dealers and the IRA market. A regulatory definition that cannot function or be harmonized with generations of practice unless it is re-worked through a dizzying array of carve-outs and exemptions is, axiomatically, a definition that does not faithfully interpret the words Congress wrote.

ERISA does not allow for this expansive new definition. Indeed, as discussed below, its plain text precludes it.¹

A. The Proposed Definition Conflicts With ERISA's Plain Text.

ERISA is a "comprehensive and reticulated statute," *Nachman Corp. v. PBGC*, 446 U.S. 359, 361 (1980), and its definition of "fiduciary" is no different. Under ERISA,

[A] person is a fiduciary with respect to a plan *to the extent* (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) *he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so*, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan.

29 U.S.C. § 1002(21)(A) (emphasis added).

Congress did not develop this provision in a vacuum, but drew from existing law. *See, e.g., Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, 110-11 (1989). That included the law of trusts and the law embodied in, and developed under, the IAA. *See infra* pp. 4-6.

¹ For simplicity, this comment refers to the proposed rule's interpretation of ERISA's definition of "fiduciary," but the discussion applies equally to the Code's definition of "fiduciary," which is identical as relevant here.

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In interpreting the definition of “fiduciary,” therefore, both the common law of trusts and the IAA must be consulted, since it is presumed that “Congress is knowledgeable about existing law pertinent to the legislation it enacts.” *Goodyear Atomic Corp. v. Miller*, 486 U.S. 174, 185 (1988).

1. A fundamental principle of trust law is that a “fiduciary” relationship arises only under certain circumstances, specifically, where “special intimacy or . . . trust and confidence” exists between the parties. *Bogert’s Trusts & Trustees* § 481; *see also Black’s Law Dictionary* 753 (rev. 4th ed. 1951) (defining “fiduciary” based on the “trust and confidence involved” in the relationship). For example, at the time of ERISA’s enactment, courts had held relationships such as physician-patient or director-corporation/stockholder to be fiduciary based on the particularly close and trusting relationship between the parties. *See, e.g., Twin-Lick Oil Co. v. Marbury*, 91 U.S. 587, 588 (1876) (recognizing that “a director of a joint-stock corporation occupies [a] fiduciary relation[ship] [and] his dealings with the subject-matter of his trust or agency, and with the beneficiary or party whose interest is confided to his care” are protected by courts); *Hammonds v. Aetna Cas. & Sur. Co.*, 237 F. Supp. 96, 102 (N.D. Ohio 1965) (deeming physician a “fiduciary” to his patient where patient “entrusted” information to the doctor).

Relationships lacking that special degree of “trust and confidence”—such as everyday business interactions—are not fiduciary. The court in *In re Codman*, 284 F. 273, 274 (D. Mass. 1922), for example, rejected the contention that “the relation of the broker to his margin customers is a fiduciary or trust relation,” describing it instead as a “debtor and creditor” relationship. And in *Robinson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 337 F. Supp. 107, 113-14 (N.D. Ala. 1971), the court concluded that a broker “had no fiduciary relationship to the plaintiff” where he was merely “executing the plaintiff’s orders on an open market.”

These principles were well established by the time of ERISA’s enactment and were incorporated into ERISA. *See Bruch*, 489 U.S. at 110-11. As the report of the House of Representatives stated in setting out ERISA’s definition of the term, “[a] fiduciary is one who occupies a position of confidence or trust.” H.R. Rep. No. 93-533, at 11 (1973); *see also id.* (“The fiduciary responsibility section, in essence, codifies and makes applicable to these fiduciaries certain principles developed in the evolution of the law of trusts.”). One who does not occupy that position of heightened trust and confidence cannot be considered a fiduciary under ERISA.

2. The law of trusts is not the only body of law that informs the meaning of “fiduciary” in ERISA. So, too, does the law embodied in, and developed under, the IAA. In the investment-advice prong of ERISA’s definition of fiduciary, Congress used the phrase

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“renders investment advice for a fee or other compensation.” That language reflects terminology in the IAA, which for decades had held a central place in the regulation of investment advisers, and which defines “investment adviser” as a person who “*for compensation . . . advis[es] others . . . as to the value of securities or as to the advisability of investing in, purchasing, or selling securities.*” 15 U.S.C. § 80b-2(a)(11) (emphasis added).

The language and history of the Advisers Act is informative of ERISA’s meaning in two ways. First, by the time of ERISA’s enactment, investment advisers were widely understood to be fiduciaries—and the *reason* they were fiduciaries was that they had a closer, deeper relationship with their clients than did other financial professionals. Thus, the Supreme Court wrote in 1963 that the Advisers Act “reflects a congressional recognition of the delicate fiduciary nature of an investment advisory relationship”; therefore, “Congress recognized the investment adviser to be” “a fiduciary.” *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191, 194-95 (1963). In reaching this conclusion, the Court relied on legislative history that recognized the “personalized character of the services of investment advisers,” *id.* at 191, and cited congressional testimony that characterized investment advisers as having relationships of “trust and confidence with their clients,” *id.* at 190 (internal quotation marks omitted). The Court cited this legislative history two decades later in reiterating the fiduciary “character” of the investment-adviser relationship. *Lowe v. SEC*, 472 U.S. 181, 190 (1985). Being an investment adviser, the Court said, is a “personal-service profession [which] depends for its success upon a *close personal and confidential relationship* between the investment-counsel firm and its client. It requires *frequent and personal contact* of a professional nature between [the advisers] and [their] clients.” *Id.* at 195 (emphases altered and internal quotation marks omitted).

Second and related, when investment advisers were being described by the Court as having the sort of “close and personal” relationship with clients—characterized by “frequent and personal contact”—that rose to the level of a fiduciary relationship, the Court was not considering investment advisers in isolation, but rather *in contrast with* other financial professionals whose relationships did not rise to the same level, namely, broker-dealers. Thus, the Advisers Act included a carve-out which clarified that “investment adviser” did not include “any broker or dealer” who provided advice that was “solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor.” 15 U.S.C. § 80b-2(a)(11)(C).

This exemption from the definition of investment adviser was not introduced by the IAA, the D.C. Circuit has explained, but “reflected [a] distinction” then existing between the “two general forms of compensation” that financial professionals received in connection with offering investment assistance. *Fin. Planning Ass’n v. SEC*, 482 F.3d 481, 485 (D.C. Cir. 2007). “Some [representatives] charged only . . . commissions (earning a certain amount for

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each securities transaction completed). Others charged a separate advice fee (often a certain percentage of the customer's assets under advisement or supervision)." *Id.* This difference in compensation structures—and the notion that a fee for *advice* was suggestive of a fiduciary relationship, whereas a commission on a sale was not—was captured by the IAA in the broker-dealer exemption. A financial representative became an "investment adviser" when "[a]t least part [of] the charge to customers receiving advice [was] attributable to such advice," but not where the payment was principally for the sale of the product. SEC Op., 1940 SEC LEXIS 1466, at *7 (1940); *see also Thomas v. Metro. Life Ins. Co.*, 631 F.3d 1153, 1166 (10th Cir. 2011) ("[T]he IAA excludes a broker-dealer who provides advice that is attendant to, or given in connection with, the broker-dealer's conduct as a broker or dealer, so long as he does not receive compensation that is (1) received in exchange for the investment advice, as opposed to . . . the sale of the product, and (2) distinct from a commission or analogous transaction-based form of compensation for the sale of a product."). As explained in the Senate and House reports, the broker-dealer exemption was "so defined as specifically to exclude . . . brokers (insofar as their advice is merely incidental to brokerage transactions for which they receive only brokerage commissions)." S. Rep. No. 76-1775, at 22 (1940); H.R. Rep. No. 76-2639, at 28 (1940).

Following the IAA's enactment, this limitation on "investment advice" was repeatedly recognized and enforced. In *Robinson*, for example, the district court concluded that the broker was not an investment adviser and "had no fiduciary relationship to the plaintiff" where "any investment advice was incidental to brokerage services." 337 F. Supp. at 113-14. The SEC emphasized that "render[ing] investment advice merely as an incident to . . . broker-dealer activities" does not by itself place broker-dealers "in a position of trust and confidence as to their customers." Broker-Dealer Registration, Exchange Act Release No. 4048, 1948 WL 29537, at *7 (Feb. 18, 1948), *aff'd*, *Hughes v. SEC*, 174 F.2d 969 (D.C. Cir. 1949). *See also Kaufman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 464 F. Supp. 528, 538 (D. Md. 1978) (broker not an investment adviser where "[t]here is no indication that [defendant] received any fees specifically for his advising [plaintiff]; rather it appears that the commissions received were for his services in effecting the transactions, not for his rendering of advice").

3. This understanding of what made investment advisers' relationship fiduciary in character—as well as the form of compensation associated with it, and the difference from a simple broker-dealer relationship—was well established when ERISA was enacted in 1974. Accordingly, when Congress used the phrase "renders investment advice for a fee or other compensation" in ERISA's fiduciary definition, it "is deemed to [have] know[n] the . . . judicial gloss given to [that] language and thus [to have] adopt[ed] the existing interpretation unless it affirmatively act[ed] to change the meaning," *Blitz v. Donovan*, 740 F.2d 1241, 1245 (D.C. Cir. 1984) (internal quotation marks omitted). *See also United States v. Wells*,

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519 U.S. 482, 491 (1997) (it is presumed “that Congress incorporates the common-law meaning of the terms it uses if those terms have accumulated settled meaning under the common law and the statute does not otherwise dictate” (alterations and internal quotation marks omitted)); *Corning Glass Works v. Brennan*, 417 U.S. 188, 201 (1974) (“[W]here Congress has used technical words or terms of art, ‘it [is] proper to explain them by reference to the art or science to which they [are] appropriate.’” (alterations in original) (quoting *Greenleaf v. Goodrich*, 101 U.S. 278, 284 (1880))). Any interpretation of the investment-advice prong must therefore be consistent with (1) the recognition under the law of trusts that only relationships marked by a heightened degree of trust and confidence are fiduciary, and (2) the common law recognition—embodied in the IAA—that broker-dealers providing advice incidental to the sale of a product are not providing *investment advice* in a *fiduciary* capacity. That meaning cannot be altered by Department of Labor regulation. See *Chevron U.S.A. Inc. v. Nat’l Res. Def. Council, Inc.*, 467 U.S. 837, 842-43 (1984); *Thiess v. Witt*, 100 F.3d 915, 918 (Fed. Cir. 1996) (agency interpretation of “compensation” impermissible because it conflicted with the term’s established meaning in the employment context).

The current regulatory interpretation, which was adopted shortly after enactment of ERISA, reflected these established limitations on the meaning of “fiduciary.” See 29 C.F.R. § 2510.3-21(c). The 1975 regulation appropriately clarifies that investment advice will trigger fiduciary duties only when rendered “on a regular basis to the plan,” “pursuant to a mutual agreement” that the services will be a “primary basis” on which the plan makes investment decisions. *Id.* Providing advice “on a regular basis,” for example, reflects the Supreme Court’s recognition in *Lowe*, 472 U.S. at 191-95, that a fiduciary typically renders advice in a close relationship characterized by “frequent” contact. This helps ensure presence of the heightened “trust and confidence” associated with fiduciary status, and that the advice is not merely “incidental” to the sale of a product.

The Department’s proposal, by contrast, radically departs from these settled limitations. The proposed rule conflicts with trust-law principles because it would deem persons not in special relationships of “trust and confidence”—e.g., broker-dealers executing sales—to be fiduciaries. To make a person a “fiduciary” for providing a “one-time . . . recommendation or valuation” (80 Fed. Reg. at 21,934), for example, cannot reasonably be viewed as consistent with the special relationship of trust and confidence envisioned under the law of trusts—a relationship, the Supreme Court has said, characterized by “frequent and personal contact.” *Lowe*, 472 U.S. at 195 (emphasis omitted). The proposal reflects no consideration of this trust-law principle (or others)—even though the DOL acknowledges that the law of trusts must inform its interpretation of ERISA, 80 Fed. Reg. at 21,932, 21,938.

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The method applied by the Department in its proposal is instead to identify acts that in its opinion *should be* performed by fiduciaries, and then to dub those actors fiduciaries even when under the accepted meaning of that term and as a matter of historical fact, they are not. In doing so, the Department departs not only from the accepted understanding of what relationships are fiduciary in character, but also from the statutory requirement that an investment fiduciary “render[] investment advice for a fee.” Under this language, it is the “advice” that must be the thing paid for, not the product that the purchaser selects, or the transaction she conducts.² Because a commissioned broker-dealer is only paid if a product is purchased, the client’s payment is plainly for the product, not for advice that might have accompanied the sale.

The very definition of a broker is a “person engaged in the business of effecting transactions in securities for the account of others,” 15 U.S.C. § 78c(a)(4)(A); by definition, he does not provide investment advice for a fee. Congress recognized this in the IAA by excluding ordinary broker services from the “investment adviser” definition, as discussed above. The Department’s proposed definition ignores that exclusion, and instead encompasses many activities customarily performed by broker-dealers that are not properly considered “advice.” For example, under the proposal, a broker’s sales pitch is transformed into advice when provided to a retail investor, but the same pitch is not advice when made to an “expert plan investor.” The Department’s reasoning that an expert buyer will understand “that it is buying an investment product, not advice,” but that a retail buyer will not (80 Fed. Reg. at 21,941-42), has no basis in principle or the long-standing financial regulatory framework established by Congress. Sales pitches are a common experience, whether for cars, electronics, or a range of financial products, and no ground exists for concluding that a broker’s offer is transformed into “advice” when tendered to a potentially less sophisticated buyer.

The extent to which the Department’s proposal captures activities ordinarily conducted by broker-dealers is, in fact, powerful evidence of the over-breadth of its “fiduciary” definition. At law, fiduciaries and broker-dealers are distinct, and broker-dealers are paid by commission. But with its proposal, the Department first mis-defines “fiduciary”

² The Department’s proposed interpretation is also inconsistent with the term “render.” To “render” is “to pronounce or declare (a judgment, verdict, etc.), as in court,” *Webster’s New World Dictionary* 1136 (3d ed. 1988), or “to furnish for consideration, approval, or information: as (1) to hand down (a legal judgment) (2) to agree on and report (a verdict),” *Merriam-Webster’s Collegiate Dictionary* 1054 (11th ed. 2003). That means something more than merely making investment suggestions in the context of a sales transaction.

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so broadly that it sweeps in hundreds of thousands of broker-dealers, and then locates a supposed conflict of interest in broker-dealers being paid in exactly the manner they by definition *are* paid. *See Fin. Planning Ass'n*, 482 F.3d at 485 (“Some [representatives] charged only commissions (earning a certain amount for each securities transaction completed). Others [which the Advisers Act treats as fiduciaries] charged a separate advice fee (often a certain percentage of the customer’s assets under advisement or supervision).”). It is not broker-dealers’ compensation structure that is flawed, it is the Department’s attempt to define broker-dealers as fiduciaries.

B. The Department’s Interpretation Also Conflicts With The Statutory Definition Of “Fiduciary” As A Whole.

Section 3(21) of ERISA identifies three ways that a person or entity becomes a fiduciary: by (i) “exercis[ing] any discretionary authority or discretionary control” over the “management” of a plan or its assets; (ii) “render[ing] investment advice for a fee or other compensation, direct or indirect”; and (iii) exercising “discretionary authority or discretionary responsibility in” the plan’s “administration.” 29 U.S.C. § 1002(21)(A). The management and administration of a plan are central functions, involving a meaningful, substantial, and ongoing relationship to the plan. Subsection (ii) must be read in a manner consistent with these provisions. Congress would not, for two of the provisions, have required a substantial and direct connection to the essentials of plan operation, and for the provision lying in-between have required only a short-term relationship whose essence was sales rather than significant investment advice provided on a regular basis. *See Pollard v. E.I. du Pont de Nemours & Co.*, 532 U.S. 843, 852 (2001) (“[W]e must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law.” (alteration in original and internal quotation marks omitted)); *Garcia v. Vanguard Car Rental USA, Inc.*, 540 F.3d 1242, 1247 (11th Cir. 2008) (“By construing proximate statutory terms in light of one another, courts avoid giving ‘unintended breadth to the acts of Congress.’” (quoting *Gustafson v. Alloyd Co.*, 513 U.S. 561, 575 (1995))). This further demonstrates that the definition in the proposed regulation is overbroad.

C. The Department Errs By Inexplicably Departing From Its 2005 Advisory Opinion To Treat Actions In Connection With Rollovers As Fiduciary.

A significant consequence of the errors by the Department described above is that the proposed rule would make *any* advice regarding investments of distributions from an ERISA plan or IRA “fiduciary advice,” regardless whether the advice is merely incidental to a sale (or proposed sale), or whether it is specifically paid for, or even related to assets no longer held by the plan. Thus, the proposed rule appears so broad that it might cover advice

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regarding investment of a distribution from an ERISA plan into an equity or debt security rendered on a one-time basis.

That is improper, and directly contradicts the DOL's conclusion just ten years ago that a recommendation regarding a rollover of plan assets to an IRA does not constitute fiduciary advice. *See* Advisory Opinion 2005-23A. For an act to be fiduciary in character, ERISA (and the Code) require, first, there be "advice" related to an "investment." 29 U.S.C. § 1002(21)(A)(ii). A distribution is not an investment; it follows that a recommendation to rollover plan assets is outside the scope of the statute because it does not "concern[] a particular investment."³ *Advisory Opinion 2005-23A*. Second, advice provided with respect to the *proceeds* of a distribution does not fall within ERISA because the statute requires that the advice relate to "any moneys or other property of [the ERISA] plan." 29 U.S.C. § 1002(21)(A)(ii). Upon distribution, the proceeds are no longer "moneys or other property" of the plan and therefore do not fall within the scope of the statute. *See* *Advisory Opinion 2005-23A*; *see also, e.g., Beeson v. Fireman's Fund Ins. Co.*, 2009 WL 2761469, at *6 (N.D. Cal. Aug. 31, 2009) (stating that "providing financial advice as to the investment of non-plan assets is generally not a fiduciary duty under ERISA" and noting that a DOL publication "[did] not state that providing investment advice (or hiring advisors to do so) will be considered a fiduciary act simply because the advice may cause participants to remove money from a plan").

ERISA's plain language, accordingly, permits only one conclusion about whether actions in connection with rollovers are fiduciary: They are not. Unlike the 2005 Advisory Opinion, the DOL's current position regarding rollovers cannot be reconciled with the statutory text. For that reason, it is precluded. *See Chevron*, 467 U.S. at 842-43.

II. The Department Lacks Statutory Authority To Adopt Its New Proposed Regulatory Framework.

Together, the Department's "fiduciary" rule and "BIC" Exemption would impermissibly expand the Department's authority outside its jurisdiction. As the Department admits, the principal goal of the rulemaking is to regulate IRAs and the broker-dealers who offer them (*see* 80 Fed. Reg. at 21,928, 21,932)—even though the DOL has no enforcement authority over IRAs. Congress, moreover, recently made clear that the SEC, not the DOL, should be the arbiter of what fiduciary standards of conduct should govern broker-dealers,

³ Similarly, providing a valuation opinion or appraisal is not equivalent to "render[ing] investment advice." The valuation provides information regarding the market value of a security or other property, but does not itself recommend its purchase.

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and what regulatory action should be taken, if any. In addition, the DOL's proposed BIC Exemption, which would affect most of the IRA market, purports to create a private right of action for plans and participants to sue broker-dealers who offer IRAs for breach of contract. But only Congress may create private rights of action, *Alexander v. Sandoval*, 532 U.S. 275, 286 (2001), and nothing in ERISA or the Internal Revenue Code permits the cause of action proposed in the BIC Exemption. In fact, section 4975 of the Code, which prohibits certain transactions involving IRAs, does not provide for any civil enforcement. The BIC is also flawed because the DOL lacks authority to ban class action waivers in arbitration agreements, *cf.* 15 U.S.C. § 78o(o) (permitting SEC to regulate arbitration agreements of "customers or clients of" broker-dealers for disputes arising under the securities laws and regulations), and its attempt to enact such a ban conflicts with the mandate of the Federal Arbitration Act ("FAA") that arbitration agreements be enforced according to their terms, *CompuCredit Corp. v. Greenwood*, 132 S. Ct. 665, 669 (2012).

In short, DOL is the regulator of neither the IRA market in particular nor the financial industry in general, and it cannot regulate through "exemption" matters that are beyond its authority to regulate affirmatively. In a word, it cannot create "backdoor regulation" by "manipulat[ing] the safe harbor criterion [of a regulation] to compel different or broader compliance" by actors in that field. *Hearth, Patio & Barbecue Ass'n v. U.S. Dep't of Energy*, 706 F.3d 499, 507-08 (D.C. Cir. 2013).

A. The SEC, Not The DOL, Has Authority To Establish Standards Of Conduct For Broker-Dealers.

The DOL seeks to apply fiduciary standards of conduct to broker-dealers. Congress, however, recently considered the process for a possible extension of fiduciary duties to broker-dealers, and in Dodd-Frank gave the SEC, which has nearly eighty years' experience regulating financial markets, the authority to adopt a uniform fiduciary standard following a study of the effects of such a regulatory change, and subject to certain express limitations. This recent demonstration of congressional intent confirms that the Department lacks the power to promulgate the proposed rules.

Section 913 of Dodd-Frank directs the SEC to evaluate the standards of care that currently govern broker-dealers and investment advisers. Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 913, 124 Stat. 1376, 1824 (2010). Specifically, it instructs the SEC to consider "the potential impact of eliminating the broker and dealer exclusion from the definition of 'investment adviser' under section 202(a)(11)(C) of the Investment Advisers Act of 1940[.]" *Id.* § 913(c)(10). Dodd-Frank also empowers the SEC to "promulgate rules to provide that, with respect to a broker or dealer, when providing personalized investment advice about securities to a retail customer . . . the

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standard of conduct . . . shall be the same as the standard of conduct applicable to an investment adviser.” *Id.* § 913(g)(1).

The DOL’s attempt to establish a new standard of care for broker-dealers disregards Congress’s expressed directive that such a decision is for the SEC. The Supreme Court recently instructed that, where “a question of deep economic and political significance that is central to [a] statutory scheme” exists, “had Congress wished to assign that question to an agency, it surely would have done so expressly.” *King v. Burwell*, No. 14-114, 2015 WL 2473448, at *8 (U.S. June 25, 2015) (internal quotation marks omitted). Further, “[i]t is especially unlikely that Congress would have delegated this decision to [an agency] [with] no expertise” in the matter. *Id.* Congress gave DOL no such authority here, but *did* expressly assign the question of further broker-dealer regulation—which would have broad effects on financial professionals and their clients—to an agency with expertise in the industry: the SEC. In doing so, Congress did not leave the door open for DOL to use the Tax Code to craft and impose its own fiduciary duties for more than half the assets in broker-dealer retail customer accounts.

The Department’s encroachment on the SEC (and FINRA) is also foreclosed by *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 143, 161 (2000). There, the Supreme Court held that the Food and Drug Administration lacked authority to regulate tobacco because of the “tobacco-specific legislation that Congress ha[d] enacted over the [previous] 35 years.” *Id.* at 143. At the time a statute is enacted, the Court explained, it may have “a range of plausible meanings” that could seem to permit agency regulation, but “[o]ver time . . . subsequent acts can shape or focus those meanings.” *Id.* In particular, later-enacted statutes that “more specifically address the topic at hand” may occupy the field in a manner that forecloses agency action, even if that subsequent legislation does not explicitly block the agency’s jurisdiction. *See id.* at 127, 143, 157. So, here, even if DOL once possessed authority to promulgate regulations of the nature proposed (it did not), Dodd-Frank “more specifically address[es]” procedures for evaluating the standard of care for broker-dealers, committing it to SEC review and, possibly, SEC regulation. Action on the subject is foreclosed to the Department.

The specific terms of the Department’s proposed rules are barred as well. Dodd-Frank requires that any new standard of conduct for broker-dealers be “the same” as “applicable to an investment adviser under section 211” of the Advisers Act. Dodd-Frank § 913(g). The standards imposed by the new rules are far more onerous than under the IAA. In Dodd-Frank Congress also provided that “[t]he receipt of compensation based on commission or other standard compensation for the sale of securities shall not, in and of itself, be considered a violation of such standard applied to a broker or dealer.” *Id.* DOL’s

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“fiduciary” rule makes broker-dealers’ “standard compensation” a prohibited transaction, with only partial relief (supposedly) available through the unadministrable BIC Exemption.

The Dodd-Frank provisions regarding a potential uniform fiduciary standard show the analysis underlying the Department’s rules to be flawed as well. Congress instructed the SEC to conduct a study and report to Congress before adopting a new standard for broker-dealers, enumerating in detail the potential effects on customers that the SEC study “shall” consider, including “the potential impact on access of retail customers to the range of products and services offered by brokers and dealers,” and loss of access to “personalized investment advice.” Dodd-Frank §§ 913(c)(9)-(10), 913(d). Commenters in the current rulemaking will show that these (and other) effects of the Department’s rules will be severe, yet the Department makes no attempt to consider these effects in its “regulatory impact analysis.” That is clear error: The proposals’ effect on access to professional financial assistance was an “important aspect of the problem” that the Department was obligated to consider under any circumstance, *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983), and certainly the Department could not fail to address the issue when Congress directed the SEC to consider that very thing before imposing fiduciary standards on broker-dealers. The Department must conduct that assessment and make it available for public review and comment. See *Chamber of Commerce v. SEC*, 443 F.3d 890, 894, 900 (D.C. Cir. 2006).

The inappropriateness of the DOL leaping out in front of the SEC is confirmed by the findings of SEC staff in the study they performed under Dodd-Frank. After examining the potential effect of eliminating the broker-dealer exclusion, SEC staff recommended against such an amendment, in view of the negative effect on consumers. SEC Study on Investment Advisers & Broker-Dealers 140, 152 (2011). As the staff explained: “If, in response to the elimination of the broker-dealer exclusion, broker-dealers elected to convert their brokerage accounts from commission-based accounts to fee-based accounts, certain retail customers might face increased costs, and consequently the profitability of their investment decisions could be eroded, especially accounts that are not actively traded[.]” *Id.* at 152 (footnote omitted). IRAs are just such accounts, yet the DOL fails to give appropriate consideration to those adverse effects.

Others with responsibility over broker-dealers have voiced similar concerns. The Chairman and CEO of FINRA, Richard Ketchum, has said the SEC “should lead” the drafting of a fiduciary standard applicable to broker-dealers, because it has the necessary expertise and is better positioned than DOL to design and implement the standard. *Oversight of the Financial Industry Regulatory Authority: Hearing Before the Subcomm. on Capital Mkts. & Gov’t Sponsored Enters. of the H. Comm. on Fin. Servs.*, 114th Cong. (2015) (statement of Richard G. Ketchum, Chairman and CEO of FINRA). In testimony before

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Congress, Chairman Ketchum expressed concern that the DOL's proposed rule would result in conflicting standards of care and stated that "the right way to move forward is for . . . the [SEC] to look [at] the possibility of a balanced fiduciary standard across all products." *Id.* These cautions from the self-regulatory organization with responsibility over broker-dealers should be given great weight, and further demonstrate why proceeding with these proposed rules is particularly inappropriate in light of the SEC's authority over the financial industry.

B. The Department Cannot Leverage Its Interpretive Authority To Exercise Enforcement Authority Not Conferred By Congress.

The DOL does not have regulatory authority over IRAs because IRAs—when sold to individual clients—are not "employee welfare benefit plans" or "employee pension benefit plans" that are "established or maintained by an employer or by an employee organization." *See* 29 U.S.C. § 1002(1) & (2). To be sure, the Department has authority to interpret the definition of "fiduciary" under ERISA and the Internal Revenue Code. Its *enforcement* authority, however, is limited to ERISA. *See* Reorganization Plan No. 4 of 1978, § 105. Only the Treasury Department has authority to enforce Section 4975 of the Code, an authority that is restricted to imposing excise taxes and conducting audits. *Id.* As the DOL acknowledges in the proposal, ERISA's duties of prudence and loyalty do not apply to IRA fiduciaries, and IRA fiduciaries are not liable under ERISA for losses arising from breaches of such duties: "Under the Code, advisers to IRAs are subject only to the prohibited transaction rules," and "no private right of action under ERISA is available to IRA owners." 80 Fed. Reg. at 21,938.

This admission is fatal to the DOL's attempt in the BIC Exemption to leverage its interpretive authority into enforcement power over matters outside the Department's jurisdiction. Among other things, DOL conditions the BIC Exemption—which is necessary for the rule's newly-discovered fiduciaries to continue long-standing compensation practices—on the fiduciary's consent to be sued by ERISA plans, IRAs, participants, and others for breach of contract related to the best interest standards created in the rule. Proposed Best Interest Contract Exemption, 80 Fed. Reg. 21,960, 21,962, 21,972 (Apr. 20, 2015) (to be codified at 29 C.F.R. pt. 2550). That is a new private right of action. It is axiomatic, however, that only Congress, not an agency, may create a cause of action. In *Sandoval*, for instance, the Supreme Court rejected the government's argument that "the regulations contain rights-creating language and so must be privately enforceable." 532 U.S. at 291. "Language in a regulation may invoke a private right of action that Congress through statutory text created, but it may not create a right that Congress has not. . . . [I]t is most certainly incorrect to say that language in a regulation can conjure up a private cause of action that has not been authorized by Congress." *Id.* (citation omitted).

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What *Sandoval* forbids is what the DOL attempts to do. Nothing in ERISA or the Code even hints that a state-law contract action can be brought against purported fiduciaries to enforce statutory provisions. ERISA's civil remedies are limited both in nature and scope, *Great-W. Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204, 209-10 (2002), and the statute broadly preempts most state law, including breach-of-contract actions, *Cromwell v. Equicor-Equitable HCA Corp.*, 944 F.2d 1272, 1275 (6th Cir. 1991). Further, ERISA's remedies have no application to non-ERISA plans such as IRAs. See 29 U.S.C. § 1002(1) & (2). The remedies under the Code are even more restricted than ERISA's, extending only to conducting audits and imposing taxes. 26 U.S.C. § 4975; see also Reorganization Plan No. 4 of 1978, § 105. Accordingly, ERISA, the Code, and basic principles of separation of powers preclude DOL's attempt to create its new "BIC" private rights of action. See also *Mertens v. Hewitt Assocs.*, 508 U.S. 248, 254 (1993) (stating Court's "unwillingness to infer causes of action in the ERISA context, since that statute's carefully crafted and detailed enforcement scheme provides strong evidence that Congress did *not* intend to authorize other remedies that it simply forgot to incorporate expressly" (internal quotation marks omitted)); *Transamerica Mortg. Advisors, Inc. v. Lewis*, 444 U.S. 11, 19 (1979) ("[I]t is an elemental canon of statutory construction that where a statute expressly provides a particular remedy or remedies, a court must be chary of reading others into it.").

It is no answer that the DOL has interpretative authority with respect to the definition of "fiduciary" in both statutes. The courts will reject an agency's attempt to use interpretive authority to regulate beyond that authority. In *American Bankers Ass'n v. SEC*, 804 F.2d 739, 754-55 (D.C. Cir. 1986), for example, the D.C. Circuit explained that "[t]he [Commission] cannot use its definitional authority to expand its own jurisdiction and to invade the jurisdiction" of other agencies through rulemaking. In that case, the agency was authorized to regulate banks, not broker-dealers, but wrongly sought to "redefine" "bank" in a way that gave it authority over broker-dealers as well. *Id.* at 742-43. See also *Business Roundtable v. SEC*, 905 F.2d 406, 412-13 (D.C. Cir. 1990) (SEC had power to mandate listing standards, but exceeded its authority by attempting to leverage that power to regulate corporate governance). And in *Home Care Ass'n of America v. Weil*, 2014 U.S. Dist. LEXIS 176307, at *14-15 (D.D.C. 2014), the court rejected the DOL's attempt to use "its definitional authority" in a way that eliminated part of a statutory exemption, explaining that "Congress surely did not delegate to the Department of Labor . . . the authority to issue a regulation that transforms defining statutory terms into drawing policy lines." So, here, the DOL seeks to define "fiduciary" in a way that gives it authority over plans and persons outside its reach, and then—having defined the term in an impossibly onerous manner—wields its exemptive authority to offer clemency to those who are willing to accede to new duties and private rights of action that have no basis in the statute DOL administers. But the Department may not conduct "backdoor regulation" through manipulation of "safe harbor criterion." *Hearth, Patio & Barbecue Ass'n*, 706 F.3d at 507-08. See also *Chamber of*

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Commerce v. U.S. Dep't of Labor, 174 F.3d 206, 210 (D.C. Cir. 1999) (concluding OSHA had authority to conduct inspections, but could not use that as “leverage” to impose obligations not required by law).

“[I]t is fundamental that an agency may not bootstrap itself into an area in which it has no jurisdiction.” *Adams Fruit Co. v. Barrett*, 494 U.S. 638, 650 (1990) (internal quotation marks omitted). That is what the DOL attempts to do through these proposals, and for this reason too, the proposals are impermissible.

C. The Department Lacks Authority To Ban Class Action Waivers In Connection With Arbitration Agreements.

The Department also exceeds its statutory authority by purporting, in the BIC Exemption, to bar all waivers of participation in class actions or other representative actions, without regard to whether those waivers are in connection with arbitration agreements. 80 Fed. Reg. at 21,973, 21,985.

Under the FAA, valid arbitration agreements must be enforced according to their terms unless the FAA “has been overridden by a contrary congressional command.” *CompuCredit*, 132 S. Ct. at 669 (internal quotation marks omitted); *see also, e.g., Am. Express Co. v. Italian Colors Rest.*, 133 S. Ct. 2304, 2309-11 (2013) (rule applies even to statutes that “expressly permit[] collective actions”). This includes arbitration provisions containing class waivers, which the Supreme Court has repeatedly upheld. *Italian Colors*, 133 S. Ct. at 2312; *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1748 (2011). “When [Congress] has restricted the use of arbitration,” moreover, “it has done so with . . . clarity.” *CompuCredit*, 132 S. Ct. at 672.

Nothing in ERISA gives DOL clear authority—or any authority—to preclude financial institutions and their clients from entering into and enforcing arbitration agreements that include class waivers. *See Kramer v. Smith Barney*, 80 F.3d 1080, 1084 (5th Cir. 1996) (“Congress did not intend to exempt statutory ERISA claims from the dictates of the [FAA].”); *Bird v. Shearson Lehman/Am. Express, Inc.*, 926 F.2d 116, 120 (2d Cir. 1991) (concluding ERISA does not preclude waiver of a judicial forum for ERISA claims). As for Code Section 4975, it is not enforceable through a private right of action at all, *see supra*,

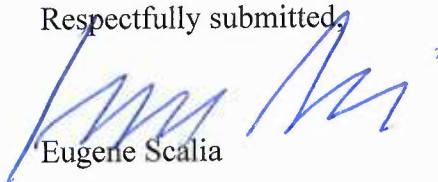
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and plainly furnishes DOL no authority to regulate parties' arbitration agreements. Simply, DOL's lack of authority to regulate arbitration agreements is dispositive of its attempt to bar class waivers in those agreements. *See CompuCredit*, 132 S. Ct. at 672.

In this respect, as in so many others in this bundle of proposed rules, the Department has overstepped its bounds.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read "Eugene Scalia", is written over the typed name.

Eugene Scalia

ES/bmr

cc: Office of Exemption Determinations

APPENDIX 7



July 20th, 2015

U.S. Department of Labor
Office of Regulations and Interpretations
Employee Benefits Security Administration
200 Constitution Avenue, NW
Washington, DC 20210

Re: Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice (RIN 1210-AB32)

Ladies and Gentlemen:

Thank you for the opportunity to provide comments regarding the Department of Labor's ("Department") Proposed Conflict of Interest Rule ("Proposed Rule") and Best Interest Contract Exemption ("BIC Exemption") under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). I am concerned that the Proposed Rule and BIC Exemption will unnecessarily increase barriers for Middle-Income Americans to the valuable retirement savings education and assistance that I and many thousands of other registered representatives provide. It is my hope that my comments are helpful to the Department.

I have been a registered representative with PFS Investments Inc. since 1994. My office is in Londonderry, New Hampshire. My clients come from the community in which I live and work. They are hard-working, very busy people, and, quite typically, before they meet me, no one has ever taken the time to sit down with them to assess their financial picture and discuss basic financial concepts with them, such as the power of saving for retirement through systematic investing and what investment options are available to them. They, like so many people in Middle America, do what they do daily very well, but the reality of life is that there is no time left in the day after their work day and evening family commitments end for them to proactively seek out education and advice on saving and investing. What some view as basic saving and investing concepts that everyone already knows, is typically not information they know. They are starting from a different baseline, and it takes a substantial time commitment to understand these concepts well enough to make actual investment decisions independently.

While it may appear that they *have access* to this information if they have computers or other mobile devices from which they can search the internet, they do not, in my experience, *access* this information on their own. It is time-consuming and overwhelming. They are much more comfortable working with a live person, and more successful when they do so, both of which

studies have demonstrated.¹ And with retirement savings and retirement plan participation at such low levels, it is imperative that we help Middle-Income Americans in every way possible get on track toward ensuring better futures for themselves and their families.

Working with Middle-Income Americans to achieve their financial goals is what I have done my entire career in the financial services industry. A story about a particular client of mine comes to mind.

About four years ago I met a newly married couple in their early thirties who invited me to help with their finances. The husband was a high school teacher and the wife was an office administrator for a small business. Additionally, the husband worked as a bartender to earn additional income. They had just bought a condominium and had one child with the desire to have another. They also wanted to retire and wanted more information about how to better budget their money. They had some debt, and the wife had a small amount saved in a 401k. Both had SIMPLE IRAs provided by the small businesses where they worked. Despite having these options they were not on track to reach their retirement savings goal. They had never completed a retirement calculation and were blown away at the potential to reach their goal if they made some changes. This education empowered them to make better decisions for themselves. They made some adjustments to their SIMPLE IRA savings. They also chose to each open IRAs by investing \$100 per month. The wife also chose to rollover her 401k savings because she wanted more investment options and was not satisfied with the level of support her employer's plan offered. She valued the one-on-one education and assistance I provided. I periodically check-in with them. We recently met, and I am proud to say they did not need to conduct any transactions because they are now on track to retire at 67 based on their current incomes. They also rent the condo where we initially met and own a house. They are doing well financially.

It is my belief that the Proposed Rule and the BIC Exemption as drafted will eliminate or substantially reduce people like this couple's access to education and advice, at the exact time and for the exact purpose they need it most – saving for retirement. I fear that the translation of education into advice, the imposition of the new BIC contract, the uncertainties created by the Impartial Conduct Standards which substantially increase liability costs and effectively disqualify the commission model, and the costs of complying with all of the many disclosure requirements will cause firms such as PFS Investments Inc. to conclude that it simply is not feasible to open smaller accounts. If a decision like this is made, my clients will lose access to the education and advice they so badly need, and their futures will be severely negatively impacted as a result.

¹ Oliver Wyman: The role of financial advisors in the US retirement market (July 6, 2015). Oliver Wyman states that it "... was engaged to perform a rigorous investigation of the role of financial advisors in the US retirement market, and quantify differences in investing behavior and outcomes between advised and non-advised individuals."

It is my hope that the Department will take this into consideration and withdraw the Proposed Rule. Thank you again for the opportunity to comment.

Sincerely,

A handwritten signature in black ink that reads "Daniel Campagna". The script is cursive and fluid, with the first name "Daniel" and last name "Campagna" clearly legible.

Daniel Campagna
Londonderry, New Hampshire

APPENDIX 8



July 20, 2015

U.S. Department of Labor
Office of Regulations and Interpretations
Employee Benefits Security Administration
200 Constitution Avenue, NW
Washington, DC 20210

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(RIN 1210-AB32)

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Thank you for the opportunity to provide comments regarding the Department of Labor’s (“Department”) Proposed Conflict of Interest Rule (“Proposed Rule”) and Best Interest Contract Exemption (“BIC Exemption”) under the Employee Retirement Income Security Act of 1974, as amended (“ERISA”). I am concerned that the Proposed Rule and BIC Exemption will unnecessarily increase barriers for Middle-Income Americans to the valuable retirement savings education and assistance that I and many thousands of other registered representatives provide. It is my hope that my comments are helpful to the Department.

I have been a registered representative with PFS Investments Inc. since 1999. My office is in Rosedale, New York. My clients come from the community in which I live and work. They are hard-working, very busy people, and, quite typically, before they meet me, no one has ever taken the time to sit down with them to assess their financial picture and discuss basic financial concepts with them, such as the power of saving for retirement through systematic investing and what investment options are available to them. They, like so many people in Middle America, do what they do daily very well, but the reality of life is that there is no time left in the day after their work day and evening family commitments end for them to proactively seek out education and advice on saving and investing. What some view as basic saving and investing concepts that everyone already knows, is typically not information they know. They are starting from a different baseline, and it takes a substantial time commitment to understand these concepts well enough to make actual investment decisions independently.

While it may appear that they *have access* to this information if they have computers or other mobile devices from which they can search the internet, they do not, in my experience, *access* this information on their own. It is time-consuming and overwhelming. They are much more comfortable working with a live person, and more successful when they do so, both of which studies have demonstrated.¹ And with retirement savings and retirement plan participation at such low levels, it is imperative that we help Middle Americans in every way possible get on track

¹ Oliver Wyman: The role of financial advisors in the US retirement market (July 6, 2015). Oliver Wyman states that it “. . . was engaged to perform a rigorous investigation of the role of financial advisors in the US retirement market, and quantify differences in investing behavior and outcomes between advised and non-advised individuals.”

toward ensuring better futures for themselves and their families. This is particularly true in the African-American community, of which my clients and I are a part. African Americans lag behind the general population in saving for retirement,² and I spend a significant amount of time educating my clients about the importance of saving for retirement and the ways they can do so.

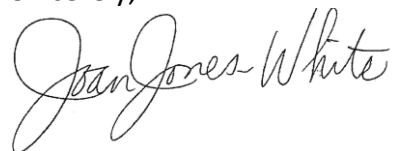
Working with Middle-Income Americans to achieve their financial goals is what I have done my entire career in the financial services industry. A story about a particular client of mine comes to mind.

Thirteen years ago I met a 26 year-old Registered Nurse. She was saving money in a bank account instead of an IRA because she was a little leery about investing in the stock market. She had accumulated several thousand dollars in the bank account. I worked with her one-on-one to educate her about basic investing concepts. For example, I explained how mutual funds operate, the importance of diversifying investments, and the benefits of tax-advantaged savings. The education provided her the understanding and confidence to open an IRA with the money she had saved in the bank account. She also chose to make monthly contributions of \$100 per month. Today she is comfortable and satisfied with the decisions she made back then. She has even increased her retirement savings contributions to the maximum allowed. I communicate with her periodically to ensure her needs are met.

It is my belief that the Proposed Rule and the BIC Exemption as drafted will eliminate or substantially reduce people like this Registered Nurse's access to education and advice, at the exact time and for the exact purpose they need it most – saving for retirement. I fear that the translation of education into advice, the imposition of the new BIC contract, the uncertainties created by the Impartial Conduct Standards which substantially increase liability costs and effectively disqualify the commission model, and the costs of complying with all of the many disclosure requirements will cause firms such as PFS Investments Inc. to conclude that it simply is not feasible to open smaller accounts. If a decision like this is made, my clients will lose access to the education and advice they so badly need, and their futures will be severely negatively impacted as a result.

It is my hope that the Department will take this into consideration and withdraw the Proposed Rule. Thank you again for the opportunity to comment.

Sincerely,

A handwritten signature in cursive script that reads "Joan Jones-White". The signature is written in dark ink and is positioned above the printed name.

Joan Jones-White
Rosedale, New York

² The African American Financial Experience, Prudential Research, 2013-14; The Hispanic American Financial Experience, 2014 Prudential Research; Rhee, Nari, Ph.D., National Institute on Retirement Security, "Race and Retirement Insecurity in the United States," (December 2013).

APPENDIX 9



July 20, 2015

U.S. Department of Labor
Office of Regulations and Interpretations
Employee Benefits Security Administration
200 Constitution Avenue, NW
Washington, DC 20210

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Thank you for the opportunity to provide comments regarding the Department of Labor's ("Department") Proposed Conflict of Interest Rule ("Proposed Rule") and Best Interest Contract Exemption ("BIC Exemption") under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). I am concerned that the Proposed Rule and BIC Exemption will unnecessarily increase barriers for Middle-Income Americans to the valuable retirement savings education and assistance that I and many thousands of other registered representatives provide. It is my hope that my comments are helpful to the Department.

I have been a registered representative with PFS Investments Inc. since 1995. My office is in Lakewood, Washington. My clients come from the community in which I live and work. They are hard-working, very busy people, and, quite typically, before they meet me, no one has ever taken the time to sit down with them to assess their financial picture and discuss basic financial concepts with them, such as the power of saving for retirement through systematic investing and what investment options are available to them. They, like so many people in Middle America, do what they do daily very well, but the reality of life is that there is no time left in the day after their work day and evening family commitments end for them to proactively seek out education and advice on saving and investing. What some view as basic saving and investing concepts that everyone already knows, is typically not information they know. They are starting from a different baseline, and it takes a substantial time commitment to understand these concepts well enough to make actual investment decisions independently.

While it may appear that they *have access* to this information if they have computers or other mobile devices from which they can search the internet, they do not, in my experience, *access* this information on their own. It is time-consuming and overwhelming. They are much more comfortable working with a live person, and more successful when they do so, both of which studies have demonstrated.¹ And with retirement savings and retirement plan participation at

¹ Oliver Wyman: The role of financial advisors in the US retirement market (July 6, 2015). Oliver Wyman states that it "... was engaged to perform a rigorous investigation of the role of financial advisors in the US retirement

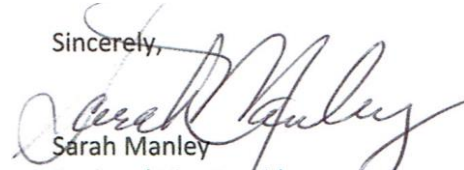
such low levels, it is imperative that we help Middle Americans in every way possible get on track toward ensuring better futures for themselves and their families.

Working with Middle-Income Americans to achieve their financial goals is what I have done my entire career in the financial services industry. A story about a particular client of mine comes to mind.

Several years ago I met a young couple with small children who lived in a duplex and earned a modest income. They provided me an opportunity to conduct a Financial Needs Analysis. The education I provided taught them how to more effectively pay off consumer debt they were paying. It also empowered them to begin saving a small monthly amount in an IRA. They were so excited! I spoke with them a few weeks ago. The choice to invest in an IRA helped them demonstrate tangible assets, which helped them qualify for their first mortgage. I am pleased to say that they continue to save toward their retirement every month. They are even confident that they will increase their savings in the future. This couple needed the opportunity to start small and grow. They can save more as their income grows but starting, even at a small amount, is the key. Many potential investors need to start small and often can't meet the larger minimums of other types of in-person investment services.

It is my belief that the Proposed Rule and the BIC Exemption as drafted will eliminate or substantially reduce people like this young couple's access to education and advice, at the exact time and for the exact purpose they need it most – saving for retirement. I fear that the translation of education into advice, the imposition of the new BIC contract, the uncertainties created by the Impartial Conduct Standards which substantially increase liability costs and effectively disqualify the commission model, and the costs of complying with all of the many disclosure requirements will cause firms such as PFS Investments Inc. to conclude that it simply is not feasible to open smaller accounts. If a decision like this is made, my clients will lose access to the education and advice they so badly need, and their futures will be severely negatively impacted as a result.

It is my hope that the Department will take this into consideration and withdraw the Proposed Rule. Thank you again for the opportunity to comment.

Sincerely,

Sarah Manley

market, and quantify differences in investing behavior and outcomes between advised and non-advised individuals.”

APPENDIX 10



July 20th, 2015

U.S. Department of Labor
Office of Regulations and Interpretations
Employee Benefits Security Administration
200 Constitution Avenue, NW
Washington, DC 20210

Re: Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice (RIN 1210-AB32)

Ladies and Gentlemen:

Thank you for the opportunity to provide comments regarding the Department of Labor's ("Department") Proposed Conflict of Interest Rule ("Proposed Rule") and Best Interest Contract Exemption ("BIC Exemption") under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). I am concerned that the Proposed Rule and BIC Exemption will unnecessarily increase barriers for Middle-Income Americans to the valuable retirement savings education and assistance that I and many thousands of other registered representatives provide. It is my hope that my comments are helpful to the Department.

I have been a registered representative with PFS Investments Inc. since 1992. My office is in Brooklyn, New York. My clients come from the community in which I live and work. They are hard-working, very busy people, and, quite typically, before they meet me, no one has ever taken the time to sit down with them to assess their financial picture and discuss basic financial concepts with them, such as the power of saving for retirement through systematic investing and what investment options are available to them. They, like so many people in Middle America, do what they do daily very well, but the reality of life is that there is no time left in the day after their work day and evening family commitments end for them to proactively seek out education and advice on saving and investing. What some view as basic saving and investing concepts that everyone already knows, is typically not information they know. They are starting from a different baseline, and it takes a substantial time commitment to understand these concepts well enough to make actual investment decisions independently.

While it may appear that they *have access* to this information if they have computers or other mobile devices from which they can search the internet, they do not, in my experience, *access* this information on their own. It is time-consuming and overwhelming. They are much more comfortable working with a live person, and more successful when they do so, both of which

studies have demonstrated.¹ And with retirement savings and retirement plan participation at such low levels, it is imperative that we help Middle-Income Americans in every way possible get on track toward ensuring better futures for themselves and their families.

Working with Middle-Income Americans to achieve their financial goals is what I have done my entire career in the financial services industry. A story about a particular client of mine comes to mind.

Ten years after attending college together in 1991 a classmate of mine asked me to sit down with his wife and him to discuss their finances. They both earned a decent salary with no children or house. Although he was a college graduate and a genius with computers, he did not understand how money works. I discovered their finances were a disaster. They spent money like crazy and had no retirement savings. The education I provided gave them an understanding about basic financial concepts and investing they did not have. They chose to fund two IRA accounts on a monthly basis. They started with small contributions, and I have been able to encourage them to increase their contributions as they go. As the years have passed, they are grateful for the time I spent to get them on, and to keep them on, the right retirement track. They told me that having someone sit down with them helped make a positive financial difference in their lives. My experience has taught me that regardless of how educated a person may be, retirement and investment vehicles are intimidating to most people. It certainly was for this couple, yet over a decade later they are happy clients, homeowners, parents, and on their way to a brighter retirement.

It is my belief that the Proposed Rule and the BIC Exemption as drafted will eliminate or substantially reduce people like this couple's access to education and advice, at the exact time and for the exact purpose they need it most – saving for retirement. I fear that the translation of education into advice, the imposition of the new BIC contract, the uncertainties created by the Impartial Conduct Standards which substantially increase liability costs and effectively disqualify the commission model, and the costs of complying with all of the many disclosure requirements will cause firms such as PFS Investments Inc. to conclude that it simply is not feasible to open smaller accounts. If a decision like this is made, my clients will lose access to the education and advice they so badly need, and their futures will be severely negatively impacted as a result.

It is my hope that the Department will take this into consideration and withdraw the Proposed Rule. Thank you again for the opportunity to comment.

Sincerely,

¹ Oliver Wyman: The role of financial advisors in the US retirement market (July 6, 2015). Oliver Wyman states that it "... was engaged to perform a rigorous investigation of the role of financial advisors in the US retirement market, and quantify differences in investing behavior and outcomes between advised and non-advised individuals."

A handwritten signature in black ink that reads "Alex Franki". The script is fluid and cursive, with the first letters of each word being capitalized and prominent.

Alex Franki
Brooklyn, New York

APPENDIX 11



July 20th, 2015

U.S. Department of Labor
Office of Regulations and Interpretations
Employee Benefits Security Administration
200 Constitution Avenue, NW
Washington, DC 20210

Re: Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice (RIN 1210-AB32)

Ladies and Gentlemen:

Thank you for the opportunity to provide comments regarding the Department of Labor's ("Department") Proposed Conflict of Interest Rule ("Proposed Rule") and Best Interest Contract Exemption ("BIC Exemption") under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). I am concerned that the Proposed Rule and BIC Exemption will unnecessarily increase barriers for Middle-Income Americans to the valuable retirement savings education and assistance that I and many thousands of other registered representatives provide. It is my hope that my comments are helpful to the Department.

I have been a registered representative with PFS Investments Inc. since 1986. My office is in Wichita, Kansas. My clients come from the community in which I live and work. They are hard-working, very busy people, and, quite typically, before they meet me, no one has ever taken the time to sit down with them to assess their financial picture and discuss basic financial concepts with them, such as the power of saving for retirement through systematic investing and what investment options are available to them. They, like so many people in Middle America, do what they do daily very well, but the reality of life is that there is no time left in the day after their work day and evening family commitments end for them to proactively seek out education and advice on saving and investing. What some view as basic saving and investing concepts that everyone already knows, is typically not information they know. They are starting from a different baseline, and it takes a substantial time commitment to understand these concepts well enough to make actual investment decisions independently.

While it may appear that they *have access* to this information if they have computers or other mobile devices from which they can search the internet, they do not, in my experience, *access* this information on their own. It is time-consuming and overwhelming. They are much more comfortable working with a live person, and more successful when they do so, both of which

studies have demonstrated.¹ And with retirement savings and retirement plan participation at such low levels, it is imperative that we help Middle-Income Americans in every way possible get on track toward ensuring better futures for themselves and their families.

Working with Middle-Income Americans to achieve their financial goals is what I have done my entire career in the financial services industry. A story about two particular clients of mine comes to mind.

I once met a client after his prior financial representative decided to pursue a new career opportunity. The assistance I have been able to provide him over the past 25 years has helped him from making several financial mistakes. For example, he called me during the recessions of 2001 and 2008 because he needed reassurance with his IRA investments. I also recently discovered that he wanted to cash out of a variable annuity that he had purchased elsewhere and had owned for some time. I encouraged him not to cash out. He is approximately 75 years old now. After I explained the surrender fees and the lifetime income options, he changed his mind because he wanted to continue receiving lifetime income. It was the right decision for him.

Also, another gentleman and his wife who once purchased a long-term care policy from me recently expressed their desire to buy a variable annuity. The husband is about 70 years old. Despite the wife having her checkbook in hand during our conversation, I recommended they not purchase an annuity because it was not the right product for their particular circumstances. He may need some of the money that he wanted to invest in an annuity in a few years. He thanked me for the guidance I provided.

It is my belief that the Proposed Rule and the BIC Exemption as drafted will eliminate or substantially reduce people like this couple's access to education and advice, at the exact time and for the exact purpose they need it most – saving for retirement. I fear that the translation of education into advice, the imposition of the new BIC contract, the uncertainties created by the Impartial Conduct Standards which substantially increase liability costs and effectively disqualify the commission model, and the costs of complying with all of the many disclosure requirements will cause firms such as PFS Investments Inc. to conclude that it simply is not feasible to open smaller accounts. If a decision like this is made, my clients will lose access to the education and advice they so badly need, and their futures will be severely negatively impacted as a result.

It is my hope that the Department will take this into consideration and withdraw the Proposed Rule. Thank you again for the opportunity to comment.

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Sincerely,

A handwritten signature in black ink, appearing to read 'Thomas R. Pool', with a stylized, sweeping flourish at the end.

Thomas R. Pool
Wichita, Kansas

APPENDIX 12



July 20th, 2015

U.S. Department of Labor
Office of Regulations and Interpretations
Employee Benefits Security Administration
200 Constitution Avenue, NW
Washington, DC 20210

Re: Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice (RIN 1210-AB32)

Ladies and Gentlemen:

Thank you for the opportunity to provide comments regarding the Department of Labor's ("Department") Proposed Conflict of Interest Rule ("Proposed Rule") and Best Interest Contract Exemption ("BIC Exemption") under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). I am concerned that the Proposed Rule and BIC Exemption will unnecessarily increase barriers for Middle-Income Americans to the valuable retirement savings education and assistance that I and many thousands of other registered representatives provide. It is my hope that my comments are helpful to the Department.

I have been a registered representative with PFS Investments Inc. since 1983. My office is in Pittsburgh, Pennsylvania. My clients come from the community in which I live and work. They are hard-working, very busy people, and, quite typically, before they meet me, no one has ever taken the time to sit down with them to assess their financial picture and discuss basic financial concepts with them, such as the power of saving for retirement through systematic investing and what investment options are available to them. They, like so many people in Middle America, do what they do daily very well, but the reality of life is that there is no time left in the day after their work day and evening family commitments end for them to proactively seek out education and advice on saving and investing. What some view as basic saving and investing concepts that everyone already knows, is typically not information they know. They are starting from a different baseline, and it takes a substantial time commitment to understand these concepts well enough to make actual investment decisions independently.

While it may appear that they *have access* to this information if they have computers or other mobile devices from which they can search the internet, they do not, in my experience, *access* this information on their own. It is time-consuming and overwhelming. They are much more comfortable working with a live person, and more successful when they do so, both of which

studies have demonstrated.¹ And with retirement savings and retirement plan participation at such low levels, it is imperative that we help Middle-Income Americans in every way possible get on track toward ensuring better futures for themselves and their families.

Working with Middle-Income Americans to achieve their financial goals is what I have done my entire career in the financial services industry. A story about a particular client of mine comes to mind.

About thirty years ago I met a married couple at a local soccer game. The husband was a Westinghouse employee and the mother was an elementary school teacher. Neither had a good understanding of how to take care of their household finances. I was able to educate them about protecting their family with life insurance and saving for retirement by saving through their employer-provided plans and with IRAs. They each began investing \$50 per month. Over time they started saving more, and their investments grew. Tragically, the wife recently died of breast cancer, and I received the below letter from the husband soon thereafter.

Rita and Don,

I wanted to thank you so much for all you did in managing my investments. Thirty some years ago when you approached us with the different options for investing, I never would have thought it would turn out this way. When (my wife) passed I was so wrapped up in emotions and pain I didn't know which way to turn with my finances. I was so glad I could turn to you for help and advice. The way you (Primerica Investment Services) handled that very difficult situation was unbelievable. I truly appreciated how quickly and easily you turned around the investments and life insurance proceeds which have made life much easier for me and my family. Your kindness and thoughtfulness was overwhelming during this time but your financial expertise [was] unparalleled. Now in times when I need extra financial support, it is such a blessing to be able to utilize the resources you have set up for me and my family. I will never be able to replace (my wife) but because of the help you gave me, it is so comforting knowing that financially we are sound.

Thank you again for all your help.

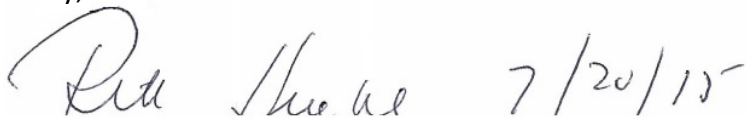
It is my belief that the Proposed Rule and the BIC Exemption as drafted will eliminate or substantially reduce people like this couple's access to education and advice, at the exact time

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and for the exact purpose they need it most – saving for retirement. I fear that the translation of education into advice, the imposition of the new BIC contract, the uncertainties created by the Impartial Conduct Standards which substantially increase liability costs and effectively disqualify the commission model, and the costs of complying with all of the many disclosure requirements, will cause firms such as PFS Investments Inc. to conclude that it simply is not feasible to open smaller accounts. If a decision like this is made, my clients will lose access to the education and advice they so badly need, and their futures will be severely negatively impacted as a result.

It is my hope that the Department will take this into consideration and withdraw the Proposed Rule. Thank you again for the opportunity to comment.

Sincerely,

A handwritten signature in cursive script that reads "Rita Huckle" followed by the date "7/20/15".

Rita Huckle
Pittsburgh, Pennsylvania

APPENDIX 13



July 20th, 2015

U.S. Department of Labor
Office of Regulations and Interpretations
Employee Benefits Security Administration
200 Constitution Avenue, NW
Washington, DC 20210

Re: Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice (RIN 1210-AB32)

Ladies and Gentlemen:

Thank you for the opportunity to provide comments regarding the Department of Labor's ("Department") Proposed Conflict of Interest Rule ("Proposed Rule") and Best Interest Contract Exemption ("BIC Exemption") under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). I am concerned that the Proposed Rule and BIC Exemption will unnecessarily increase barriers for Middle-Income Americans to the valuable retirement savings education and assistance that I and many thousands of other registered representatives provide. It is my hope that my comments are helpful to the Department.

I have been a registered representative with PFS Investments Inc. since 1983. My office is in Fort Washington, Pennsylvania. My clients come from the community in which I live and work. They are hard-working, very busy people, and, quite typically, before they meet me, no one has ever taken the time to sit down with them to assess their financial picture and discuss basic financial concepts with them, such as the power of saving for retirement through systematic investing and what investment options are available to them. They, like so many people in Middle America, do what they do daily very well, but the reality of life is that there is no time left in the day after their work day and evening family commitments end for them to proactively seek out education and advice on saving and investing. What some view as basic saving and investing concepts that everyone already knows, is typically not information they know. They are starting from a different baseline, and it takes a substantial time commitment to understand these concepts well enough to make actual investment decisions independently.

While it may appear that they *have access* to this information if they have computers or other mobile devices from which they can search the internet, they do not, in my experience, *access* this information on their own. It is time-consuming and overwhelming. They are much more comfortable working with a live person, and more successful when they do so, both of which

studies have demonstrated.¹ And with retirement savings and retirement plan participation at such low levels, it is imperative that we help Middle-Income Americans in every way possible get on track toward ensuring better futures for themselves and their families.

Working with Middle-Income Americans to achieve their financial goals is what I have done my entire career in the financial services industry. A story about a particular client of mine comes to mind.

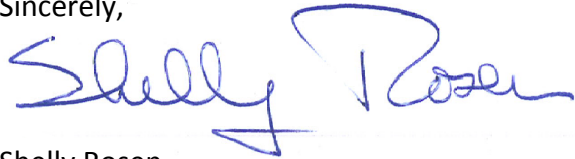
About 15 years ago I sat down with a married couple in their home because the wife asked me to review their financial situation. The husband earned very good money working as a railroad engineer, the wife worked in the home, and they had one daughter. Despite earning a good income on the railroad the family had a sizeable amount of consumer debt and no savings. One reason was due to the wife spending a lot of money buying gifts for others. After introducing them to basic financial concepts I was able to help them establish a financial game plan to get rid of their debt and start saving for retirement. For example, I informed the wife she could express generosity to her friends and family by writing personal letters or providing baking goods instead of spending money she did not have on expensive consumer items. They chose to follow my guidance by paying down their debts, opening an emergency account, and an IRA in which they invested \$50 per month. The financial knowledge I gave them empowered them to learn more on their own which led to more questions. Since I do not charge by the hour like fee-based advisers do it freed them to ask as many questions as they would like. We had several conversations about the fees involved in their investment transactions. After a five to seven year process they had erased all their debt and increased their retirement savings along the way. One day the wife left a message on my answering machine thanking me for turning her whole life around. She had no debt, and she had emergency savings and retirement savings.

It is my belief that the Proposed Rule and the BIC Exemption as drafted will eliminate or substantially reduce people like this couple's access to education and advice, at the exact time and for the exact purpose they need it most – saving for retirement. I fear that the translation of education into advice, the imposition of the new BIC contract, the uncertainties created by the Impartial Conduct Standards which substantially increase liability costs and effectively disqualify the commission model, and the costs of complying with all of the many disclosure requirements will cause firms such as PFS Investments Inc. to conclude that it simply is not feasible to open smaller accounts. If a decision like this is made, my clients will lose access to the education and advice they so badly need, and their futures will be severely negatively impacted as a result.

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It is my hope that the Department will take this into consideration and withdraw the Proposed Rule. Thank you again for the opportunity to comment.

Sincerely,

A handwritten signature in blue ink that reads "Shelly Rosen". The signature is fluid and cursive, with the first name "Shelly" and the last name "Rosen" clearly distinguishable.

Shelly Rosen
Fort Washington, Pennsylvania

APPENDIX 14



July 20th, 2015

U.S. Department of Labor
Office of Regulations and Interpretations
Employee Benefits Security Administration
200 Constitution Avenue, NW
Washington, DC 20210

Re: Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice (RIN 1210-AB32)

Ladies and Gentlemen:

Thank you for the opportunity to provide comments regarding the Department of Labor's ("Department") Proposed Conflict of Interest Rule ("Proposed Rule") and Best Interest Contract Exemption ("BIC Exemption") under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). I am concerned that the Proposed Rule and BIC Exemption will unnecessarily increase barriers for Middle-Income Americans to the valuable retirement savings education and assistance that I and many thousands of other registered representatives provide. It is my hope that my comments are helpful to the Department.

I have been a registered representative with PFS Investments Inc. since 1996. My office is in Blue Springs, Missouri. My clients come from the community in which I live and work. They are hard-working, very busy people, and, quite typically, before they meet me, no one has ever taken the time to sit down with them to assess their financial picture and discuss basic financial concepts with them, such as the power of saving for retirement through systematic investing and what investment options are available to them. They, like so many people in Middle America, do what they do daily very well, but the reality of life is that there is no time left in the day after their work day and evening family commitments end for them to proactively seek out education and advice on saving and investing. What some view as basic saving and investing concepts that everyone already knows, is typically not information they know. They are starting from a different baseline, and it takes a substantial time commitment to understand these concepts well enough to make actual investment decisions independently.

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such low levels, it is imperative that we help Middle-Income Americans in every way possible get on track toward ensuring better futures for themselves and their families.

Working with Middle-Income Americans to achieve their financial goals is what I have done my entire career in the financial services industry. A story about a particular client of mine comes to mind.

Fifteen years ago I met a married couple who had two small IRA accounts. The husband was a manager at a local retail store and the wife was a hair dresser. They were in their late 40s or early 50s, and their IRAs each had about \$10,000 conservatively invested. I provided a financial needs analysis, and they chose to rollover their IRAs because they saw the benefit of working with a licensed financial representative like me. They wanted the education and guidance that I could provide them to help them better understand their investment options. Today, there is now well over \$100,000 in the account, and the client is debt free, including the mortgage, because of the guidance I provided. Unfortunately, the wife now has onset Alzheimer's, but she and her husband frequently visit my office just to say "hi." Her husband has thanked me for the help I provided and informed me they are better off financially because of our relationship. Main street families need the opportunity to have the human touch I provide.

It is my belief that the Proposed Rule and the BIC Exemption as drafted will eliminate or substantially reduce people like this couple's access to education and advice, at the exact time and for the exact purpose they need it most – saving for retirement. I fear that the translation of education into advice, the imposition of the new BIC contract, the uncertainties created by the Impartial Conduct Standards which substantially increase liability costs and effectively disqualify the commission model, and the costs of complying with all of the many disclosure requirements will cause firms such as PFS Investments Inc. to conclude that it simply is not feasible to open smaller accounts. If a decision like this is made, my clients will lose access to the education and advice they so badly need, and their futures will be severely negatively impacted as a result.

It is my hope that the Department will take this into consideration and withdraw the Proposed Rule. Thank you again for the opportunity to comment.

Sincerely,

A handwritten signature in cursive script that reads "Jodie Orel".

Jodie Orel
Blue Springs, Missouri