



Invested in America

April 17, 2017

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

Re: RIN 1210-AB79; Proposed Delay and Reconsideration of DOL Regulation Redefining the Term “Fiduciary”

Ladies and Gentlemen:

The Securities Industry and Financial Markets Association (“SIFMA”)¹ is pleased to provide comments regarding the Department of Labor’s (“Department”) proposed delay and reconsideration of its regulation under the Employee Retirement Income Security Act of 1974, as amended (“ERISA”), and the Internal Revenue Code of 1986, as amended (“Code”) that will redefine the term “fiduciary” under section 3(21) of ERISA and section 4975(e) of the Code (the “Rule”).

Executive Summary

SIFMA members believe that the questions raised by the President in his Presidential Memorandum on Fiduciary Duty Rule issued on February 3, 2017 are critical to a thoughtful analysis of the Rule, and will be informed by the experience that the industry has had in providing input to the Department of Labor while it was considering adoption of the Rule as well as preparing for the Rule’s applicability date. The experience of financial institutions in responding to the Rule has caused significant changes to many current business models, limiting the choices available to retirement investors and their

¹ SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over \$2.5 trillion for businesses and municipalities in the U.S., serving clients with over \$18.5 trillion in assets and managing more than \$67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit <http://www.sifma.org>.

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access to advice and increases in product pricing, which, while highlighted in our original comments as our best prediction, have actually come to pass.

The President's Memorandum provides:

one of the priorities of the Administration is to empower Americans to make their own financial decisions, to facilitate their ability to save for retirement and build their individual wealth necessary to afford typical lifetime expenses" [I]f you make an affirmative determination as to any of the considerations identified in subsection (a) or you conclude for any other reason after appropriate review that the Fiduciary Duty Rule is inconsistent with the priority identified earlier in this memorandum - then you shall publish for notice and comment a proposed rule rescinding or revising the Rule, as appropriate....

The Rule is not consistent with the Administration's stated priorities and therefore, pursuant to the instructions of the President of the United States, it must be rescinded or revised. We urge the Department to immediately issue an additional 180-day delay in the applicability dates so that the Rule and its accompanying exemptions do not go into effect until the study mandated by the President is completed, and until the President, the Secretary of Labor and his appointed staff have had an opportunity to review the record underlying the study and decide on next steps.

There is no doubt that financial institutions have found the breadth of the Rule and the complexity and pitfalls of the accompanying exemptions to be nearly impossible to adapt to current business models. Nearly every financial institution that has disclosed its plans publicly will be changing products and services available to retirement investors, restricting choices, and changing pricing.² In addition to the unworkable Rule, the many

² Michael Wursthorn. "A Complete List of Brokers and Their Approach to 'The Fiduciary Rule'." *WSJ*. 6 Feb. 2017. <https://www.wsj.com/articles/a-complete-list-of-brokers-and-their-approach-to-the-fiduciary-rule-1486413491>; Greg Iacurci . "How insurers are losing when it comes to variable annuities." *Investmentnews.com*. 30 Aug. 2016. <http://www.investmentnews.com/article/20160830/FREE/160839998/how-insurers-are-losing-when-it-comes-to-variable-annuities>; Financial Advisor IQ. "JPMorgan Halts Action as DOL Weighs Fiduciary Rule." *Financial Advisor IQ*. 13 Apr. 2017. http://financialadvisoriq.com/c/1611373/186813/jpmorgan-halts-action-weighs-fiduciary-rule?referrer_module=emailMorningNews&module_order=0&login=1&code=YW1WdWlyTm9RSE5wWm0xaExtOXlaeXdnT1RZeE5EY3lNeXdnTIRFek16azVOek00; Michael Wursthorn. "J.P. Morgan Moves Ahead With Plan to Drop Commissions in IRAs." *WSJ*. 13 Mar. 2017. <https://www.wsj.com/articles/j-p-morgan-moves-ahead-with-plan-to-drop-commissions-in-iras-1489420979>; Janet Levoux. "Merrill Kills Mutual Fund Sales in IRAs; DOL Rule Sparks Move." *Thinkadvisor.com*. 2 Nov. 2016. <http://www.thinkadvisor.com/2016/11/02/merrill-kills-mutual-fund-sales-in-iras-dol-rule-s>; Financial Advisor IQ. "JPMorgan Kills Commission IRAs as Industry Ponders Trump's DOL Stance." *Financial Advisor IQ*. 10 Nov. 2016. http://financialadvisoriq.com/c/1497033/172103/jpmorgan-kills-commission-iras-industry-ponders-trump-stance?referrer_module=emailMorningNews&module_order=1&login=1&code=WlIdaMWJtdEFjMmxtYldFdWlZSm5MQ0E0TkRNME56Z3pMQ0F4T1RjNE5UVXdoVGD6

underlying details, including the exemptions, are also unworkable. The Best Interest Contract Exemption (“BIC”) is the only real exemption proposed for retail accounts, which does not work. Thus, one response has been to avoid it by modifying business models so that there is no need to rely on BIC, either because the retirement investor will receive no advice from a financial advisor or because the only available product for a retirement investor is an asset-based fee advisory program. For individuals being directed to asset-based fee advisory programs as a result of a poorly constructed Department Rule, this could be more costly to the consumer, since, on average, asset-based fee advisory programs cost more than traditional “buy and hold” commission brokerage accounts. The other new exemption, for principal transactions, is so cumbersome that no institution has announced its intention to rely on it.

In the face of the President’s questions, the Department continues to rely upon the outdated and misapplied research found in its 2015 cost study, data that has been undercut and challenged by later studies.³ It uses this same outdated study and accompanying erroneous conclusions, which reflect none of the documented changes in the market over the last couple of years, to suggest it will not delay the Rule until the President’s mandated study is completed. The Rule and its accompanying exemptions are, plain and simple, government overreach and interference in the financial markets in a way that is detrimental to the very population it is intended to benefit. The Department’s anticipated implementation of the Rule on June 9, 2017 ignores the President’s directions.

As will be described in more detail in this comment letter, the path chosen by the former Administration has proven to be impractical, unworkable, unrealistic and therefore, unlikely to lead to better financial results for retirement savers. It will lead to greater costs, less choice and less advice as the evidence increasingly indicates:

- It limits products and services and makes both more costly to retirement investors.
- It has disrupted the industry in such a way that millions of retirement savers will be unable to purchase lifetime income options, to their detriment.
- The exemptions’ reliance on private plaintiffs to enforce the Rule significantly increases the probability of meritless litigation and will likely lead to even further increases to the costs of products and services (and/or a further reduction in the products and services made available) to retirement investors

³ Litan, R., & Singer, H. (2015). Good Intentions Gone Wrong: The Yet-To-Be-Recognized Costs of the Department of Labor’s Proposed Fiduciary Rule. *Report prepared by Economists Incorporated for the US Department of Labor*; Berkowitz, J., Comolli, R., & Conroy, P. (2015). Review of the White House Report Titled “The Effects of Conflicted Investment Advice on Retirement Savings”.

to reflect the risk of, and expense associated with defending disruptive class actions.

The President's Memorandum states that if the Department finds evidence of limited access and choice for retirement investors, increased litigation, and disruption in the industry that adversely affects retirement investors, it must rescind or revise the Rule. We respectfully submit that a review of the record before the Department should lead to this conclusion.

Further, SIFMA believes that achieving a best interest standard should be accomplished by establishing a uniform best interest legal standard for broker-dealers that applies to all retail brokerage accounts. We believe this goal could be accomplished without the overly broad conditions, unnecessary subjectivity, and overlapping and expensive requirements currently contained in the Rule, and particularly the BIC exemption.

We appreciate the opportunity to comment and hope that our comments are helpful in pointing out areas where the Rule would: (i) adversely affect the ability of millions of Americans to save for retirement; (ii) increase the costs of retirement accounts while limiting the availability of advice and education for retirement investors; and (iii) vastly increase the amount of litigation to which our members will be subject. We look forward to working with the Department to avoid these results. We anticipate working with the Department to revise the entire Rule, as oppose to discussions focused on operationalizing the Rule as currently drafted.

Delay in Applicability Date

SIFMA appreciates the Department's delay in the applicability date of the Rule but strongly disagrees with its expressed intention to allow the Rule to become effective within 60 days, even though the report mandated by the President's memorandum is not likely to be completed. This path will be chaotic for retirement investors and for the industry. The study anticipated by the President's Memorandum could very well lead to changes to the Rule itself, so it is unreasonable for the Department to implement any part of the Rule without the full study being completed. It will be of little help that the transition rules are eased when the applicability date of the full exemption requirements is unreasonably compressed with no delay at all. Later in this letter, we list the many challenges and problems with the Rule itself, which the Department might conclude needs revision since there are fundamentally different views with regard to the types of activities that constitute fiduciary advice under ERISA. The Department may very well determine that the Rule has cast too wide a net in determining who will be deemed a fiduciary by

reason of providing investment advice, particularly in light of the negative consequences we have seen.

Thus, instead of delaying the January 1, 2018 applicability date for the full requirements of the BIC exemption for the same 60-day period as the Rule, it leaves the January 1, 2018 date the same, as if the Department had already made up its mind that there would be no changes to the exemptions that would need to be planned for or accommodated or implemented. The failure to provide for an appropriate delay on the entire Rule appears to be contrary to the intent of the President's memorandum, and appears to show a prejudgment of the conclusion.

While the Department undertakes the review mandated by the President, a further delay is necessary; in the absence of a further delay, firms will move forward on spending additional hundreds of millions of dollars implementing compliance programs which could, in light of the mandated review, require significant change in a short period of time. Communications, training and implementation of policies and procedures have recently slowed down, as financial institutions hesitated to spend those hundreds of millions of dollars that will be needed to complete their compliance activities associated with the Rule and its accompanying exemptions because it might change. In an effort to avoid uncertainty and confusion among retirement investors, many potentially imminent changes in the products and services available to retirement investors have not yet been communicated and explained to retirement investors.

We urge the Department to act responsibly and without hesitation to delay the Rule and its accompanying exemptions for a time sufficient for the review to be completed, for any changes in the Rule and its accompanying exemptions to be proposed and finalized, and for the industry to fully analyze those changes to properly make the adjustments to their business models, their products and their services to reflect those changes, to communicate the changes to their financial advisors and clients in an appropriate and orderly fashion, and to train their financial advisors. It is also worth noting that compliance with the Rule continues to be a moving target, as the Department issued two FAQs, some of which include novel interpretations of the Rule – one set very late in 2016, more than six months after the publication of the Rule, and the other in January 2017. Even the delay notice included some new interpretations with regard to compliance during the transition period.

We have included an appendix to this letter that provides a path forward for the Department to allow for an extended delay to provide the Department with the time necessary to complete the thorough review required by the Memorandum to the Department. *See Appendix I.*

We urge the Department to delay the applicability date of the Rule and its accompanying exemptions until a date at least 180 days from publication in the Federal Register of any final revisions in the package, or a notice that there will be no such changes. We believe it is critical to finish the study before we reach any potential applicability date.

The President's Questions

In his Memorandum to the Department, the President expressed his concern that the Rule and its accompanying exemptions may limit access to retirement services, products, and savings information and advice; may lead to increased litigation; and may disrupt the industry in a way that adversely affects retirement savers. We believe that there is now clear and ample evidence in front of the Department that these adverse effects have, in fact, have already come to pass. This comment letter adds to the wealth of evidence before the Department of announced and contemplated changes in the offerings that will be available to retirement investors as well as the increased costs for those products and services.

I. Access to Services, Products and Retirement Savings Information

In 2015, total retirement assets in plans and IRAs are nearly \$16 trillion. More than \$7 trillion is held in IRAs. All of those accounts, as well as small plan accounts, will be significantly and adversely affected by the Rule and its accompanying exemptions. Retirement investors will lose the products and services that are currently available to them. The magnitude of the change coming for these retirement investors cannot be overstated.

Most of these assets are held in brokerage accounts containing stocks, bonds, mutual funds and annuities. To the extent that the financial institutions holding these accounts have decided to require these retirement investors to either use the internet, a robo advisor or a call center and forego conversations with financial professionals, massive consumer disruption and confusion will ensue. It is likely that these retirement savers will lose all contact with an investment professional. We estimate that millions of IRA owners will suffer this result. A recent report by CoreData Research found that a majority of advisors (71%) plan to “disengage” from a segment of investors in response to the Rule and concerns that advice will be too costly. According to the report, on average, these advisors estimate they will no longer serve 25% of their “mass-market clients,” which could create an advice gap for lower-balance investors. *See Appendix II.*

As noted throughout this comment letter, the one indisputable fact recognized by all of the literature is that retirement savers without a financial professional have lower returns than retirement savers who use a financial professional for information and education and other guidance. The value of an advisor has been estimated to be 1.59% per year, or an overall impact of a 22.6% increase in retirement income.⁴ Other research has found similar results – advised individuals, segmented by age and income, have a minimum of 25% more assets than non-advised individuals. Further, in the case of individuals aged 65 and older with \$100,000 or less in annual income, advised individuals hold an average of 113% more assets than non-advised investors.⁵ In the case of small businesses, those that work with a financial advisor are 50% more likely to set up a retirement plan, and micro businesses with 1-9 employees are almost twice as likely.⁶

Financial advisors not only add value in the form of increased retirement income, advisors also encourage clients to save holistically, not just for retirement. For nearly every listed savings goal, advisors' clients are significantly more likely to save on a regular basis compared with people who do not consult advisors.⁷ Moreover, advisors can provide high-quality financial education, a service that is at risk under the Department's Rule. A recent report found that the average financial literacy score of investors globally is "barely above a failing grade." Not surprisingly, the more financially literate investors tend to earn higher returns, earning 130 basis points ("bps") more in annual risk-adjusted returns.⁸ Over the course of 30 years, more knowledgeable investors could have retirement funds that are 25% larger.⁹

Advised investors also have more diversified portfolios – they 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.¹⁰ Unadvised

⁴ Blanchett, D., & Kaplan, P. (2013). Alpha, beta, and now... gamma. *The Journal of Retirement*, 1(2), 29-45.

⁵ Oliver Wyman, *The role of financial advisors in the US retirement market*, July 2015, <http://www.dol.gov/ebsa/pdf/1210-AB32-2-00515.pdf>

⁶ *Id.*

⁷ LIMRA, *Matters of Fact: Consumers, Advisors, and Retirement Decisions (and Results)*, May 2015, http://www.limra.com/uploadedFiles/limra.com/LIMRA_Root/Posts/PR/Media/PDFs/Facts-about-retirement-decisions.pdf

⁸ State Street Global Advisors, "Developing Financial Knowledge," (2016).

⁹ Robert Clark, Annamaria Lusardi and Olivia Mitchell, "Financial Knowledge and 401(K) Investment Performance," National Bureau of Economic Research, 2014.

¹⁰ Oliver Wyman, *The role of financial advisors in the US retirement market*, July 2015, <http://www.dol.gov/ebsa/pdf/1210-AB32-2-00515.pdf>

households tend to hold fewer equities than advised households.¹¹ The likelihood of owning any stocks or stock-based mutual funds increases by 67% with the use of an advisor and the proportion dedicated to stock positions increases by 39% when a household works with a financial advisor.¹² If the Rule results in a reduction of equity allocations by only 15%, it seems likely that such a reduction would result in a performance decline of 50-100 bps per year, on average, or \$95 billion and \$189 billion over the next 10 years and between \$202 billion and \$404 billion over the next 20 years (using a \$2 trillion asset base consistent with the assumption used in the Rule's calculation of investor gains in the mutual fund segment). This damage to retirement investors will be exacerbated by their loss of access to other key financial and retirement solutions, such as guaranteed lifetime income and long term care insurance.

Advisory Accounts

The majority of SIFMA's members provide both brokerage and advisory account options, where the client chooses the services they want to receive as well as how they choose to pay for the services for their account. Traditionally, in a brokerage account IRA, many firms have not required a minimum account size. However, because of the Rule, many financial institutions have announced that they will limit investment products available to retirement investors to advisory programs, and then only if the IRAs meet the account minimum required by the program. To put it another way, the number of IRAs in brokerage accounts will be greatly reduced. As noted throughout our comments on the proposed Rule, virtually every financial institution has a minimum asset size for investment advice in an advisory account. The majority of firms have a minimum threshold of \$25,000-50,000, and that threshold can even range upwards of \$250,000 at some firms. In 2014, 45% of IRAs were below \$25,000. About 60% of IRAs were below \$50,000. The median account balance was just a little over \$32,000. Even if one looks at the median for individuals at peak savings ages (50-65), the median account sizes are a little over \$31,000 at 50-55, a little over \$41,000 at 56-60 and a little over \$55,000 at 61-65.¹³ Thus, even more IRAs will be forced to "do it yourself" and individuals who have finally realized that they need to start planning for retirement in a serious fashion will be left without advice, or required to pay more to obtain guidance under advisory programs, and then only if their account meets the minimum account size.

¹¹ Foerster, S.R., Linnainmaa, J., Melzer, B., Previtero, A., (forthcoming), "Retail Financial Advice: Does One Size Fit All?" *Journal of Finance*.

¹² Ibbotson, Roger G. and Kaplan, Paul D., Does Asset Allocation Policy Explain 40, 90, 100 Percent of Performance? *Financial Analysts Journal*, Jan/Feb 2000, Vol. 56, No. 1. Available at SSRN: <https://ssrn.com/abstract=279096>

¹³ Copeland, C. (2017). Individual Retirement Account Balances, Contributions, Withdrawals, and Asset Allocation Longitudinal Results 2010-2014: The EBRI IRA Database.

The Department believes that over a period of years, new programs will be created to provide this much needed advice. We are concerned about a regulation that relies on the hope that programs will be created. Even if this ends up coming true, such new programs would come too late for individuals age 50 and over today. Based on financial institution planning thus far, both announced and under consideration, a significant percent of IRA owners will have an internet or a call center option where they will receive execution only services with no advice or recommendations. As the Financial Industry Regulatory Authority (“FINRA”) noted in its 2013 Report on Conflicts of Interest, commission-based accounts are usually the best choice for “buy-and-hold” investors.¹⁴ In addition, those in commission-based accounts prefer them to fee-based accounts.¹⁵ While SIFMA understands that some RIAs have announced that they will have no minimum account size for advisory accounts, we believe that will only serve a small percentage of IRA accounts.¹⁶ Further, it is very important to recognize that those firms are typically offering only one element of the services that retirement investors have come to expect from a brokerage firm. These services typically limit one-on-one conversations. Although the Department continues to dismiss the consequences felt in the United Kingdom of similar changes in advice requirements, the studies of loss of access to affordable face-to-face advice and the existence of an “advice gap,” particularly among people of lower incomes and with fewer assets, cannot be discounted.¹⁷

Annuities

Many financial institutions have signaled their reluctance to sell annuities because of the Rule and the BIC requirements. The commission structure for annuities is quite different from the commission structure for mutual funds, stocks, bonds and ETFs. While the Department has suggested in the preamble to the BIC exemption that different compensation structures can be used if they are based on neutral factors, few financial institutions have indicated a willingness to take the litigation risk on what would qualify as a neutral factor under the exemption. Since annuities provide the one place where retirement investors can obtain lifetime income guarantees, we think the reduced annuity

¹⁴ FINRA, Report on Conflicts of Interest (Oct. 2013) at 29.

¹⁵ JD Power Survey, available at <https://www.financial-planning.com/news/fiduciary-changes-could-turn-clients-off-jd-power>

¹⁶ Public Hearing Transcripts. (August 12, 2015.) at p. 243. <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB32-2/1210-AB32-2-HearingTranscript3.pdf>

¹⁷ HM Treasury. "Financial Advice Market Review, Final Report". *Fca.org.uk*. (March 2016.) <https://www.fca.org.uk/publication/corporate/famr-final-report.pdf>

sales will be unfortunate for retirement investors, especially in light of all of the press and other financial education relating to “outliving” one’s savings. Purchases for variable annuities have fallen by 21% from 2015 to 2016, according to the Secure Retirement Institute of LIMRA.¹⁸ This drop represents both the qualified and nonqualified segments of this market. For IRA purchases, sales declined 22% in 2016 when compared to the prior year.¹⁹ The ambiguous regulatory structure of the Rule is expected to result in additional decreases in purchases of variable annuities, which represents a significant amount of IRA annuity purchases. In 2015, variable annuities represented 56% of IRA annuity sales and 46% of 2016 IRA annuity sales.²⁰ LIMRA projects that variable annuity purchases will decrease another 20-25% in 2017 if the Rule goes into effect.²¹

Mutual Funds

Some institutions may choose to sell only mutual funds that adopt a uniform sales load schedule and level 12b-1 fees, and does not offer any sales-load free rights of exchange or rights of accumulation (so called T shares).²² Some financial institutions that have chosen to follow the BIC exemption have indicated that to do so, they will only be able to offer mutual fund families that create a new T share class. Ultimately, the availability of mutual fund shares to retirement accounts may significantly decline depending on the number of mutual fund families that choose to establish T Shares. Moreover, some clients would benefit from other mutual fund sales charge reduction features that are not available under the T shares structure.

Some other institutions have been considering a so-called “clean” share class, where no distribution-related charges are imposed by the fund company and the broker, acting as agent for the investor, may separately charge for their services. These are examples of the kind of changes in the market created solely to meet the Department’s Rule, but not necessarily a product that would otherwise have been developed. Further, it is worth noting that these new types of shares are in various stages of the implementation process, including some awaiting SEC approval, which will then need to be added to platforms, and then all the operational aspects that are inherent with adding a new product

¹⁸ LIMRA Secure Retirement Institute, U.S. Individual Annuity Sales Survey (Fourth Quarter 2016).

¹⁹ *Id.* See also LIMRA Secure Retirement Institute, Fourth Quarter 2016.

²⁰ U.S. Individual Annuity Databook and LIMRA Secure Retirement Institute.

²¹ Montminy, Joseph E. "Bumpy Ride Predicted for Individual Annuity Sales in 2017." *InsuranceNewsNet Magazine*. April 2017. <http://insurancenetmagazine.com/article/bumpy-ride-predicted-for-individual-annuity-sales-in-2017-3268>

²² "Morningstar: T Shares to Kill off A Shares." *Barrons.com*. 10 Jan. 2017. <http://www.barrons.com/articles/morningstar-t-shares-to-kill-off-a-shares-1484029436>

must be completed. It should be noted that uncertainty about the outcome of the Department's review will impact these efforts, which is another reason to further delay the applicability date so that firms can proceed once there is clarity.

Other Rule-Driven Changes

Other financial institutions have announced that they will only sell mutual funds and ETFs in advisory accounts and the only product available on a commission basis will be variable annuities.²³ In addition, other financial institutions have announced they will narrow the platform of investment products available to retirement investors.²⁴ Furthermore, other financial institutions will allow brokers to continue servicing IRAs on a commission basis but the advice will be generated from a central group. This may diminish the personal contact and extent of individualized advice available to those clients.

Change and Innovation

While the Department appears to take credit for these changes, we suggest that many of these changes might not be helpful for retirement investors, and differ radically from the types of beneficial innovation that financial institutions are known for – from multimanager advisory programs, target date funds, the stable value product, lifetime income products, and robo-advisers. These changes represent financial industry innovation at its best. Conversely, the changes elsewhere described in this comment letter, which were initiated only to comply with the Rule, and in virtually all cases limit what would otherwise be available to the retirement investor, result in cutbacks in the retirement services, products and information currently available to IRA owners and plan participants on a significant scale – perhaps up to 60% of all IRAs. Almost all financial institutions have announced that their services or products will change in some way. Many of these options could lead to increased costs to retirement savers.

II. SIFMA's Survey

In order to assess the anticipated impact of the Rule and its exemptions, SIFMA surveyed its membership and analyzed the results from 25 financial firms impacted by the Rule. Respondents represent a wide cross section of the industry, including a diverse set of

²³ See Footnote 2.

²⁴ Kelly, Bruce. "Ameriprise will stick with IRA commissions under DOL fiduciary rule." *Investmentnews.com*. 26 Oct. 2016. <http://www.investmentnews.com/article/20161026/FREE/161029927/ameriprise-will-stick-with-ira-commissions-under-dol-fiduciary-rule>; Michael Wursthorn. "A Complete List of Brokers and Their Approach to 'The Fiduciary Rule'." *WSJ*. 6 Feb. 2017. <https://www.wsj.com/articles/a-complete-list-of-brokers-and-their-approach-to-the-fiduciary-rule-1486413491>.

businesses and various firm sizes, including many of the industry's largest private client firms and a subset of medium and small firms.

- More than half the firms are considering moving IRA brokerage clients to call center services only. About the same number (and this could be an overlapping group) is considering moving clients to a self-directed structure. Finally, for those respondents who would be limiting services to advisory accounts or internet/call center solutions, nearly three quarters of the responding firms said their plans would not permit small accounts to have advisory accounts.
- 44% of the respondents anticipate that more than half of their clients could see a change in services (e.g., limitation of product choice, shift to fee-based account, or shift to online only, etc.). More than 50% of responding firms anticipate offering only advisory services to a subset of their current IRA brokerage customers.
- Over three quarters of the respondents stated that their Rule compliance plans could limit or restrict services or products available to certain customer segments, and 92% of the responding firms stated that their plans could limit or restrict *products* for retirement investors. According to data from the Survey of Consumer Finances, there are 12.2 million households with a brokerage IRA or an IRA and other assets.²⁵ This means that as many as 11 million households could face fewer choices as a result of the rule.
- Almost three quarters of the responding firms stated that their Rule compliance plans could limit or restrict *services* available to retirement investors. For example, firms could limit access to personal or holistic financial advice, call center services could be limited, and planning and advisory services could be limited.
- Finally, more than 60% of the responding firms stated that they anticipate that some or all of the costs resulting from the potential increase in litigation and liability insurance may be passed on to clients.

III. Increased Litigation

The Rule and its accompanying exemptions ignore the fact that in virtually every other arrangement, the parties to the arrangement have a common understanding of the services provided. As written, the Rule does not require the service provider and the

²⁵ Panis, C., Brien, M. "Brokerage Accounts in the United States." (Nov. 30, 2015)
<https://www.dol.gov/sites/default/files/ebsa/researchers/analysis/retirement/brokerageaccountsintheus.pdf>

retirement investor to have the same understanding. Current law requires a mutual understanding or agreement between the parties regarding fiduciary advice; the new Rule drops the word “mutual”. It is difficult to believe that litigation will not increase, when the arrangement’s terms need not be mutually agreed to.²⁶ SIFMA urges the Department to recognize the enormous increase in litigation that would result from allowing parties to enter into an arrangement where they have different understandings of the services being provided. As SIFMA noted in its comment on the proposed Rule, the lack of a mutual understanding:

“is inconsistent with the on-going relationship of heightened trust and confidence historically associated with fiduciary status, and with the long-standing recognition—expressly embodied in the Advisors’ Act—that a broker-dealer whose advice is merely incidental to a sale is not a fiduciary.

* * *

These changes will cause confusion and costly litigation. The second prong of this definition of “investment advice” should relate to situations where the parties *agree* that the recommendations will play a significant role in the participant’s decision-making. The Department’s proposal, however, abandons the requirement that there be a mutual understanding, agreement or arrangement between the financial professional and the advice recipient about anything at all. Indeed, the preamble specifically notes that no meeting of the minds is required.²⁷ While we would have thought eliminating the notion that the parties should reach an understanding regarding whether the intent is that the financial professional be an investment advice fiduciary was merely a drafting issue rather than a substantive one, the preamble specifically notes that no meeting of the minds is required. SIFMA believes that the Department’s elimination of the concept of a meeting of the minds opens the door to potentially false but nearly indefensible claims. This standard would allow a person who has not received fiduciary advice to later claim that he “understood” that it was investment advice, or that the financial professional “understood” that the information was targeted to the

²⁶ The Department’s explanation for dropping the word mutual is to facilitate more effective enforcement. SIFMA members believe that a claim that a relationship is a fiduciary relationship *should* be “defeated” if the parties do not mutually understand that they both intended a fiduciary relationship, with the additional liability on the part of the financial professional and the additional cost on the plan, participant or IRA owner. SIFMA does not agree with the Department’s view that striking the essential component of “mutual” agreement is justified by the stated goal of easing the burden on Department investigators and “more effective enforcement”. Indeed, the Department’s formulation requires only that if the financial professional understands that he is “specifically directing” his sales pitch to a person who has not agreed to be his client – and to whom he may never have spoken before – he becomes a fiduciary, even where the person on the other end of the phone neither sees the financial professional as a “trusted advisor” nor evidences any mutual understanding, reliance or trust of any kind.

²⁷ “The parties need not have a meeting of the minds on the extent to which the advice recipient will actually rely on the advice, but they must agree or understand that the advice is individualized or specifically directed to the particular advice recipient for consideration in making investment decisions.” 80 CFR at 21940.

person, leaving the financial firm with an impossible task of proving that the claimant could not have so understood the statement. The standard also would place courts and arbitrators in the simple, but utterly one-sided, position of assuming that any arguable “recommendation” by a broker makes the broker a fiduciary with no room to consider the facts and circumstances of the situation. The nature of the advisory relationship should be demonstrably intentional for both parties. Whether one is a fiduciary directly affects bonding decisions, liability and risk decisions, training and systems management. It governs what the client should be charged, and what the financial professional and his financial institution can receive under the Department’s proposed prohibited transaction exemptions. It should be a reasoned decision, by a plan, plan participant or IRA, to seek and agree to pay for investment advice, and both parties should understand the arrangement, the fees and the conflicts. Setting up a legal regime that allows or encourages individuals, with investment hindsight, to recast arrangements as fiduciary in nature and allow a unilateral, after the fact “understandings” regarding the nature of recommendations rather than requiring or encouraging the parties to reach an understanding up front regarding the nature of a financial professional’s role and responsibilities simply is unreasonable.”

If this lack of a meeting of the minds were not enough, the only real exemption for commission-based arrangements, the BIC exemption, requires a written contractual commitment and warranties, with the clear expressed intent of the Department to allow the standard of care and warranties to be enforced primarily in private litigation. This intention is underscored by the Department’s preamble discussion of class action litigation which must be expressly permitted under the BIC exemption contract. Thus by definition and design, the exemption is intended to be enforced almost entirely by private litigation. While the IRS has both investigative and enforcement authority over IRA prohibited transactions, the Department appears to dismiss IRS enforcement as a meaningful alternative.²⁸ The result is that the Rule and the BIC exemption provides an open invitation (a veritable “hook,” as described by Barbara Roper of the Consumer Federation of America²⁹) to private plaintiffs’ lawyers to take advantage of the retirement system by bringing lawsuits in an effort to drive defendants to settle, while exacting large legal fees, generally more than a third of the total recovery, without proving any violation and without changing or improving the offerings available to the retirement investor.

This skewed incentive for class action plaintiff’s lawyers will certainly benefit those lawyers, while the individual consumers will not be better served. In fact, in a

²⁸ We note that it seems far more reasonable to leverage the existing memoranda of understanding between the Department and the SEC and the IRS to enforce these requirements.

²⁹ FINRA. "Why Plaintiffs Firms Will Love DOL's New Fiduciary Rules - Law360." Law360.com. <https://www.law360.com/articles/781160/why-plaintiffs-firms-will-love-dol-s-new-fiduciary-rules>

proposed amicus brief filed by AARP, the American Association for Justice (formerly known as the Association of Trial Lawyers of America), the Consumer Federation of America, the Public Investors Arbitration Bar Association (PIABA), and other groups, they specifically praise the Rule's mechanism for individuals to bring litigation and class actions.³⁰ The individual clients would not receive much financial reward, since their portion would be small, while the increase in litigation costs will affect the price of available products and services for that individual consumer and all other consumers. This would be particularly harmful in the smaller firm market.

Experience in the employer stock drop arena illustrates the dangers here. Since these cases came into vogue in the early 2000's, literally hundreds of these class actions have been filed by private litigants.³¹ To date, no plaintiff has succeeded in prevailing on the merits in any of these cases involving publicly traded securities. Nevertheless, and notwithstanding Congress' clear desire to permit and promote the ownership of employer stock in individual account plans governed by ERISA, literally hundreds of millions of dollars have been spent in settlements of these cases.³² Countless more dollars have been spent in legal fees in defending these actions. Nor are those the only burdens faced by plan sponsors from these cases – class action litigation, and discovery, in particular, is inherently costly, time consuming and burdensome.

IV. Problems with the Rule Itself

We hope that the Department uses this opportunity to rescind the Rule and its accompanying exemptions necessitated by the rule, or at the very least address the myriad issues created by the Rule and the exemptions. While SIFMA supports a best interest standard when financial services firms provide individualized investment advice at the request of retirement investors, the Rule expands the scope of the statute beyond that contemplated by Congress, and is not practical, not capable of ready compliance, not realistic, and not consistent with other financial regulations.

First, the Rule lacks a clear selling exception. When salespeople make clear they are selling and they have conflicts in doing so, it is not for the Department to decide that the investor cannot possibly understand that disclosure. The Rule's preamble suggests that

³⁰ Motion of AARP, AARP Foundation, the American Association for Justice, Americans for Financial Reform, Better Markets, Inc., Consumer Federation of America, and the Public Investors Arbitration Bar Association as Amici Curiae in Support of Defendants, Thrivent Financial for Lutherans v. Thomas E. Perez, Secretary of Labor, and United States Department of Labor (Dec. 9, 2016).

³¹ According to a 2015 Cornerstone Research Study, 240 of these cases were filed between late 2001 and the end of 2015. <https://www.cornerstone.com/Publications/Research/ERISA-Company-Stock-Cases>

³² *Id.*

even a billionaire cannot decide for himself whether he needs investment advice. The Department noted in the preamble that it:

...is not prepared to adopt the approach suggested by some commenters that the provision be expanded to include individual retail investors through an accredited or sophisticated investor test that uses wealth as a proxy for the type of investor sophistication that was the basis for the Department proposing some relationships as non-fiduciary. The Department agrees with the commenters that argued that merely concluding someone may be wealthy enough to be able to afford to lose money by reason of bad advice should not be a reason for treating advice given to that person as non-fiduciary. Nor is wealth necessarily correlated with financial sophistication. Individual investors may have considerable savings as a result of numerous factors unrelated to financial sophistication, such as a lifetime of thrift and hard work, inheritance, marriage, business successes unrelated to investment management, or simple good fortune. (Footnote omitted), 81 Fed. Reg. 20981-2.

Respectfully, we think that the Department has it wrong. By refusing to exclude even the most sophisticated investors, the Department has likely eliminated a lot of what these retirement investors choose to buy, including equity IPOs, municipal bonds, private equity funds, hedge funds and private placements. By way of example, the Securities Act of 1933 and the Investment Company Act of 1940 each contain certain exemptions for investors who meet certain income or asset thresholds. By imposing a Rule and BIC exemption that may lead brokers to eliminate the brokerage options for retirement investors or to severely limit the investments made available to retirement investors, the Department has substituted its judgment for that of these retirement investors, which prevents such retirement investors from making their own choices with regard to investing their money. It is not the Department's job to limit the retirement investor's choice regarding what is best for his or her own account. This is precisely the question the President asked: are retirement investors' choices being limited? The answer is yes, even for those investors that other regulators (and Congress) have deemed able to make these choices themselves.

Even where the Department seemed to appreciate that when a financial professional urges a retirement investor to hire him, that self-proclaimed marketing should not be deemed to be fiduciary advice, the Department goes on to say that if you say anything other than "hire me", you will be giving investment advice. For example, the preamble notes:

The final Rule draws a line between an advisor's marketing of the value of its own advisory or investment management services, on the one hand, and making recommendations to retirement investors on how to invest or manage their savings, on the other. An advisor can recommend that a retirement investor enter into an advisory relationship with the advisor without acting as a fiduciary. But when the advisor recommends, for example, that the investor pull money out of a plan or invest in a particular fund, that advice is given in a fiduciary capacity even

if part of a presentation in which the advisor is also recommending that the person enter into an advisory relationship. The advisor also could not recommend that a plan participant roll money out of a plan into investments that generate a fee for the advisor, but leave the participant in a worse position than if he had left the money in the plan. Thus, when a recommendation to “hire me” effectively includes a recommendation on how to invest or manage plan or IRA assets (e.g., whether to roll assets into an IRA or plan or how to invest assets if rolled over), that recommendation would need to be evaluated separately under the provisions in the final Rule. 81 Fed. Reg. 20968.

Under the Department’s interpretation an investment manager can say “Hire me; I’m the best” but not if the only way to hire him is to roll over assets into an IRA; the Department sees that as disguised investment advice to take a distribution and roll it over to an IRA. An investment manager can say “Hire me; I’m terrific” but he cannot say “I’m terrific at fixed income management” because, according to the Department, that is considered investment advice to allocate assets to fixed income. We think this is too broad an interpretation, and too narrow an exception to create any practical likelihood that either party would understand when it is being used, creating too great an opening for plaintiff’s lawyers. That should not be the purpose or result of effective rulemaking.

SIFMA’s comments on the proposed Rule raised other common sense issues as well:

- For years, the Department took the position that advice regarding plan distributions is not fiduciary advice. The Department’s reversal of its long held view that distribution advice is not investment advice translates all distribution conversations into a fiduciary breach with no exemptive relief at all for the rollover or for any fees charged in the IRA. The Department’s second set of FAQs drive home the point:

Q4. An investment adviser who is also a licensed insurance agent approaches a client who will soon begin receiving minimum required distributions from the client’s 401(k) plan accounts and IRAs. The adviser recommends that once the client receives these required minimum distributions they should be used to fund a permanent life insurance product. The investment adviser in his or her capacity as insurance agent will receive a commission on the sale of the permanent life insurance product. Is the recommendation of the permanent life insurance product investment advice covered by the Rule?

Yes. Because the minimum required distributions are compelled by the Code, the adviser has not recommended a distribution from a plan or IRA simply by explaining the tax requirements and telling the plan participant that the law requires those distributions.

However, the adviser has made a recommendation as to how securities or other investment property of a plan or IRA should be invested after the funds are distributed from the plan or IRA within the meaning of paragraph (a)(1)(i) of the Rule.

We believe it is overbroad and beyond the Department's authority to provide a Rule that makes anyone who makes a suggestion with regard to how to use a retirement investor's plan distribution a fiduciary. Those distributions cease to be plan assets when withdrawn from the plan and moved into a brokerage, checking, savings or other type of non-retirement account. Taken to its extreme, the application of the Rule goes well beyond a financial advisor and captures salesmen of all types, including those not even remotely connected to financial services, such as a real estate salesperson recommending a vacation home to a retiree. This raises the question, and concern, with regard to where the Department's authority ends.

- Another example is found where the Rule provides an exception for participant education; however, if the participant does not understand the financial categories the financial professional is talking about, the financial professional cannot provide examples or provide detailed information that distinguishes one fund from another. But that is precisely the purpose of education. The education carve-out will be virtually useless to a participant who is not financially literate and cannot translate generalities into some realistic choices.

Suppose the financial professional says that generally, retirement savers between age 60 and 70 should have allocations to large cap growth investments and large cap value investments. If the client does not understand how to distinguish among the thousands of equity funds available, the financial professional is unable to provide examples without it being considered investment advice. If the financial advisor can't show the retirement investor two prospectuses and illustrate the differences in permitted investments, benchmarks, risks, etc., the education is not worth very much.

Lack of financial literacy is a universally recognized problem; giving asset classes without allowing examples will not help participants. They will be paralyzed by their choices, and unless they choose to pay for advice from a financial professional, their choices will be uninformed and haphazard, if not entirely incorrect, driven by confusion in the least volatile markets and panic in the most volatile markets. SIFMA believes that the education exception is

useless without examples, further leaving participants to fend for themselves. This limitation will likely have an enormous adverse effect on retirement investors.

- Still another example is the Department’s approach to rollover conversations. In an effort to discourage participants from removing their assets from employer-sponsored 401(k) plans, the Department determined that most conversations between a participant a financial professional are to be considered investment advice.
 - SIFMA does not agree with the Department that participants are not capable of distinguishing a sales call from trusted advice.³³
 - Second, it is not in the best interest of plan participants to discourage all conversations regarding distributions. Rollover education starts with an explanation of the importance of keeping assets in a retirement account.
 - Third, we agree that taking a distribution before retirement to spend on current needs could subject participants not only to a less secure financial future but potentially to current tax penalties as well. The fact that financial firms urge participants and IRA owners to keep their assets in retirement accounts and not dissipate them on boats or vacations or other discretionary spending is one of the greatest strengths of the financial professional system. If a policy goal is to avoid “leakage” out of the retirement system so Americans save sufficiently for retirement, an effective strategy to pursue that goal would be to encourage one- on- one educational conversations with investment professionals about the pitfalls of taking distributions.
 - Fourth, often financial professionals can help participants understand the importance of saving early and often for retirement and why they should consider exhausting all other resources before cashing out of

³³ Recent research suggests consumers can distinguish between a sales call and fiduciary advice. People don’t trust sales calls or other unsolicited advice. *See, e.g.*, “Trust and Financial Advice,” J. Burke and A. Hung, RAND Labor and Population Working Paper, WR-1075 (Jan. 2015), at 1. (“...we find that financial trust is correlated with advice usage and likelihood of seeking advisory services. Analysis of the experiment shows that trust is an important predictor of who chooses to receive advice, even after controlling for demographic characteristics and financial literacy. However, providing unsolicited advice has little impact on behavior, even for individuals with high levels of trust.” This finding underscores SIFMA’s view that sales conversations should not constitute fiduciary advice.

the retirement system. If every sales conversation or every educational conversation is fiduciary advice, all participants suffer.

- Leakage from retirement plans is at an epidemic high. In 2010, one in four American workers with a 401(k) or other defined contribution plan tapped their retirement account for current expenses. This “leakage” reached \$70 billion in 2010, equal to nearly a quarter of all contributions that year. As Alicia Munnell and Anthony Webb found in a study released earlier this year:

“The ability of our model to match the SIPP public use data corroborates our leakage estimates; leakages reduce wealth by 22%. They are more significant than fees (14%) but less significant than the effects of non-participation among eligible employees and the immaturity of the system (30% and 27%). In total, all these factors reduce retirement wealth by two thirds.”³⁴

- The Department’s focus has unfortunately been limited to the costs inherent in broker-sold funds, a much too narrow aspect. As has been pointed out repeatedly, we disagree strongly with that focus and the Department’s related economic analysis. But worse, the Department’s focus on the fees in broker-sold funds is to the exclusion of financial literacy, coverage and leakage. The Department clings to that analysis even when it is contradicted by actual recent experience, newer studies, or even corrections of the studies on which the Department relies.

We urge the Department to address the issues caused by its overbroad definition of fiduciary and its too narrow carve-out for educational rollover conversations and no carve-out at all for sales. The Department’s approach likely will make the problem of retirement security worse, not better.³⁵ SIFMA believes that the Department has not sufficiently considered alternatives here. FINRA issued guidance in December 2013 which

³⁴ “The Impact of Leakages from 401(k)s and IRAs”, Alicia Munnell and Anthony Webb, February 2015, at page 17.

³⁵ In 2005, the Department determined that it is not fiduciary advice when a person makes a recommendation regarding whether to take a distribution from a plan, whether that distribution should be in cash or in kind, and whether it should be rolled over to a plan or an IRA or invested in a non-tax favored account. Just five years later, in the 2010 Proposal, the Department decided that its 2005 determination was a mistake. With this 2015 iteration, the Department has decided that any recommendations about distributions, regardless of how general in nature, should be actionable fiduciary advice, regardless whether that advice relates to the securities involved in the distribution. These provisions should be reconsidered in light of the serious adverse effect they will have on savings.

provides good direction to brokers with regard to rollover conversations.³⁶ The Department has not provided any analysis as to why the flat, intentionally prohibitive approach is protective of participants or in their interest. Nor has it provided a basis for believing that the new Rules will have a positive effect on reducing leakage.

It also fails to recognize the cost and complexity of administering the accounts of participants who are no longer employees. Plan sponsors heavily depend on call centers to discuss distribution options with participants, and these call centers are an important source of one-on-one educational conversations when participants can describe their circumstances, their goals, and their concerns. But even a single balanced, factual conversation on distributions to individual participants could become fiduciary advice if it were deemed to be a recommendation directed to the participant who called. SIFMA believes that its members, plans and participants are ill-served by call center conversations that must end after the participant asks what specific alternatives exist for his or her plan account balance or IRA. This would be the result of the Department's Rule: virtually no financial institution will be permitting their call centers to provide education on rollovers that could be later challenged as advice by a private plaintiff's lawyer.

V. Problems with the BIC exemption

The Department has intentionally limited relief for IRAs to one exemption which is resulting in a wholesale revision on how financial institutions sell products and services, charge clients, pay financial professionals, sell lifetime income products and distribute investment products. This exemption is leading to a complete redesign of the retail financial world, from sales loads to revenue sharing, to revenue streams from the sale of equities and fixed income, to IPOs, from recruitment bonuses to training of financial professionals. It calls into question whether there is really any way to continue selling lifetime income products. We believe this exemption goes too far, offering solutions in search of problems, and creates more roadblocks than help for retirement investors. It should be entirely revamped.

Even the Department's delay proposal suggests that the Department is addressing problems that do not exist or are not nearly the problems they describe: actively managed funds, broker sold funds and excessive trading. "Curing" these "problems" is the express purpose of the BIC exemption despite the fact that every financial institution is required under FINRA Rule 3110 to have reasonably designed supervisory procedures, which means that these firms will have developed supervision around the suitability rule, including churning. As described in more detail elsewhere in this comment letter, the Department has no evidence for its oft-cited proposition that IRAs are plagued by excessive

³⁶ FINRA Regulatory Notice 13-45, Rollovers to Individual Retirement Accounts, December 2013.

trading. We think the evidence shows just the opposite; retirement assets are “sticky assets” and the majority of IRA owners don’t trade very much.³⁷ What is more important, however, is that the primary regulators of brokerage firms, FINRA and the SEC, have addressed these issues for more than 80 years. It is inappropriate for the Department to decide that excessive trading is now its responsibility, as if FINRA does not exist. It is disruptive for the Department to impose, through private litigation, a different regime to address an issue that another regulator has been addressing effectively for longer than ERISA has been in existence.³⁸ And FINRA’s approach is coupled with its deep understanding of the market and its recognition of how a sudden change in approach can disrupt the market and hurt investors.

Moreover, and as also discussed elsewhere in this comment letter, the Department’s criticism of broker-sold funds is outdated and incorrect. And finally, it is simply not appropriate for the Department to issue an exemption that will require a complete transformation of the retail financial services business to address a problem not yet identified or verified.

The President asks whether the Rule will cause disruption in the industry. In order to comply with or avoid the BIC exemption, firms have made or plan to make very significant changes to their product and service offerings to retirement investors, limiting their choices of services and products.³⁹ It has also required them to make very significant changes to their businesses, as highlighted earlier. It is a very challenging exemption to deal with, due to scores of separate requirements, any one of which, if not complied with, can trigger the loss of the exemption, reversal of the transactions dependent on the exemption, payment of an excise tax under the prohibited transaction provisions of the Internal Revenue Code and the potential of a private class action lawsuit. There is also such a significant amount of subjectivity to those requirements that firms have been rightly

³⁷ Johnson, Woodrow T., Do Investors Trade Uniformly through Time? (Aug. 20, 2009); Journal of Empirical Finance, Vol. 17, No. 4, 2010. Available <https://ssrn.com/abstract=891739>

³⁸ Furthermore, the BIC Exemption, which is designed to address material conflicts of interest relating to commissions, is also unnecessary as a regulatory tool since FINRA’s own suitability rule, and its enforcement department, already specifically addresses churning, which is excessive trading designed to benefit an advisor’s compensation. In Supplementary Guidance 2110.05, FINRA directly addresses a requirement for a member firm to ensure that trading in any brokerage account (including IRAs) is “not excessive and unsuitable.” In addition, FINRA Enforcement takes action against individual firms and registered representatives who churn IRA accounts. (See e.g., Richard Gomez, FINRA Case No. 2014039358003; Gomez was suspended for one year for excessively trading two IRA accounts of senior investors.) The DOL has not demonstrated that FINRA is unable or incapable of enforcing its very own conflict of interest rule regarding compensation derived from excessive trading in IRA accounts. Thus, the BIC Exemption does not fill a regulatory void. FINRA already has in place in its own rules and tools to police the misconduct identified by the DOL.

³⁹ See Footnote 2.

concerned will lead to a misinterpretation of the BIC exemption requirements. These legitimate concerns have led to many financial institutions deciding that they simply will not take on the risk of failure to comply with the BIC exemption. As a result, firms have determined that the best way to address this risk is to change their business models, in whole or in part, which limits investor choice, to avoid these expensive risks.

Private right of action. We have already discussed the private right of action inherent in the contractual undertakings required by the BIC exemption. If the Department believes these rules cannot be enforced through reversals of transactions and excise taxes, then it should find a different way for the government to enforce them. The Department should not leave enforcement to the inconsistent and often capricious private plaintiff's bar. For example, the Department should at least consider enforcement by the financial institutions' primary regulators, who know the industry and have examined these institutions on a regular basis.⁴⁰

The "without regard to" standard. The exemption requires financial advisors to give advice that meets the prudence standard of ERISA, which is appropriate. However, it also requires that the advice be given "without regard to the financial interest of the advisor or the financial institution." As SIFMA stated in its previous letter to the Department, that standard requires that the advisor *not know* what his financial interests are with respect to the recommendation of a service or a product, which is an impossible standard. The concept may be directionally correct but we had asked that the Department use the more common and more readily understood concept: that the advisor place his client's interest before his own.

Identification of every conflict of interest. The BIC exemption requires that compensation be reasonable and that statements by the financial advisor not be misleading when made, which is appropriate. However, the BIC exemption then requires that the Financial Institution warrant to its retirement investor clients that it has adopted policies and procedures reasonably designed to ensure that the advisors adhere to the impartial conduct standards, and that the policies and procedures have:

specifically identified and documented its Material Conflicts of Interest; adopted measures reasonably and prudently designed to prevent Material Conflicts of

⁴⁰ FINRA Rule 4530(b) requires broker dealers to self-report to FINRA material violations of law that are systemic and widespread in nature. All the firms have well-developed processes to follow this rule if there is a systemic violation of the BIC Exemption:

"(b) Each member shall promptly report to FINRA, but in any event not later than 30 calendar days, after the member has concluded or reasonably should have concluded that an associated person of the member or the member itself has violated any securities-, insurance-, commodities-, financial- or investment-related laws, rules, regulations or standards of conduct of any domestic or foreign regulatory body or self-regulatory organization."

Interest from causing violations of the Impartial Conduct Standards set forth in Section II(c); and designated a person or persons, identified by name, title or function, responsible for addressing Material Conflicts of Interest and monitoring their Advisers' adherence to the Impartial Conduct Standards.

This is where the Department goes awry. It is almost impossible to “specifically identify” and “document” every Material Conflict of Interest, where Material Conflict of Interest is defined as any conflict that could affect the exercise of a financial advisor’s best judgment as a fiduciary.⁴¹ Even the most well-intentioned financial institution attempting to comply with the exemption will be challenged to specifically identify every conceivable conflict that could, in theory, have such an impact; a failure to identify a conflict that did not seem material to the financial institution could result in loss of the exemption. Our members work diligently to identify and mitigate, where appropriate, material conflicts of interest under FINRA rules today.

However, the penalty for missing one conflict that the firm had not identified is particularly harsh in this context. Every transaction for which relief is needed would need to be reversed and an excise tax paid. Further, because of the subjective nature of the test – whether such a conflict could affect one’s best judgment as a fiduciary – there could very well be inadvertent omissions. Institutions attempting to comply with the BIC exemption have spent the better part of the last year trying to identify and address the Material Conflicts of Interest.

Compensation of Advisors. Even more difficult for the financial institutions that have spent the last year trying to build a program that complies with the BIC exemption is its requirement that the policies and procedures require:

that neither the Financial Institution nor (to the best of its knowledge) any Affiliate or Related Entity⁴² use or rely upon quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation or other actions or incentives that are intended or would reasonably be expected to cause Advisers to make recommendations that are not in the Best Interest of the Retirement Investor.

This warranty appears to require the overhaul of the compensation structure of

⁴¹ A “Material Conflict of Interest” exists when an Adviser or Financial Institution has a financial interest that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary in rendering advice to a Retirement Investor. *See* Exemption, Section VIII(i).

⁴² Related Entity is defined as any entity in which the financial institution has an interest that might affect its best judgment. What is the threshold? How does one draw a line? Is it a controlling interest? Is it 25% and two board seats? This is another example of the complications with complying with the exemption. The Department has suggested informally that the industry is “overreading” these requirements. However, when the penalty for a misstep is the unavailability of the exemption, reversal of all transactions under it, the payment of an excise tax and a private plaintiff’s class action, firms lean towards a cautious reading.

almost every financial institution. The suggested approaches in the preamble to the final exemption are to substitute varying compensation with an asset based compensation structure, regardless if any products or services are sold. While the Department allows compensation to be based on neutral factors, firms have struggled with applying that standard, which has resulted in leaning towards payment of an asset based fee as the primary way to meet the Department's suggested compensation structure. However, it would not be commercially reasonable for a firm to take the financial risk of paying an advisor asset based compensation regardless of whether the account is generating enough revenue to pay that compensation to the advisor. This answers another of the President's questions: has the Rule increased the costs of retirement accounts and inhibited the availability of advice and education for retirement investors? With just the very few examples noted in this comment letter, the answer is an emphatic yes. After an enormous amount of work and consideration, many financial institutions have concluded that it is simply too hard to manage the Department's BIC exemption without taking on unreasonable risk. A one size fits all approach is not the right outcome – retirement savers should have choice. We believe that putting a client's interest ahead of one's own can be accomplished far more simply.

We repeat the remarks of the FINRA, submitted during the comment period on the proposed rule in 2015, which turned out to be prescient:

While right directionally, I have practical concerns with the Labor proposal in a number of areas. First, the warranty and contractual mechanism employed by Labor used to address their limited IRA enforcement jurisdiction, appears to me to be problematic. In one sweeping step, this moves enforcement of these provisions to civil class action lawsuits or arbitrations where the legal focus must be on a contractual interpretation. I am not certain how a judicial arbiter would analyze whether a recommendation was in the best interests of the customer “without regard to the financial or other interests” of the service provider. I'm not sure, but I suspect, a judicial arbiter might draw a sharp line prohibiting most products with higher financial incentives no matter how sound the recommendation might be. Similarly, I'm not sure how a judicial arbiter would evaluate which compensation practices “tend to encourage” violations of the exemption. It would appear likely, however, that firms would be required to demonstrate, at least, that any higher compensation was directly related to the time and expertise necessary to provide advice on the product, as specifically suggested by DOL. To say the least, making that case is not a simple proof standard.

This all leads to my second concern that there is insufficient workable guidance provided either to the firm or the judicial arbiter on how to manage conflicts in most firms' present business models other than moving to pure asset-based fees, or a completely fee-neutral environment. It is not that Labor's conflict concerns don't have validity; it is that I fear that the uncertainties stemming from

contractual analysis and the shortage of useful guidance will lead many firms to close their IRA business entirely or substantially constrain the clients that they will serve. Put another way, the subjective language of the PTE, coupled with a shortage of realistic guidance, may lead to few providers of these critical investor services.⁴³

It is not a “principles based” change to require this kind of massive overhaul in the way all brokers are compensated. In 2010, the Department suggested that it wanted a change in the law to make its enforcement program easier. We are very concerned that this exemption has the same aim, but at a huge cost to the financial services industry and importantly, those saving for retirement. We strongly urge the Department to reconsider this requirement.

Transaction Disclosure. The BIC exemption has a two tier transaction disclosure requirement which will drive additional costs of compliance to firms. The on-demand transaction disclosure has the potential to delay transactions which would be harmful to retirement investors and is operationally challenging due to the complexity and recordkeeping requirements.

The exemption gives retirement investors the right to request disclosure of costs, fees and other compensation including Third Party Payments associated with a recommended transaction from the financial institution and financial advisor. The requirement for on-demand disclosure creates a number of problems. One of those problems is timing. If the retirement investor makes the request before the trade, it will impact the timing of the trade, most likely causing a delay of the recommended transaction. The condition indicates that the requested information “must be provided prior to the transaction if requested before the transaction”. A retirement investor who makes such a request is, in effect, stepping in front of the trade. As stated above, full and prominent disclosure that is brought to the attention of the retirement investor will do far more to inform clients about fees and compensation.

The on-demand requirement also creates operational difficulties. If the disclosure is to be generated systemically, a number of operational steps need to occur to gather the data that often resides on different systems. Effectively, this condition requires multiple systems to coordinate and provide the information requested. No one system holds all the details which can be compiled and easily presented to a retirement investor. For example, security systems, holding certain detail about the securities a firm trades in, would need to

⁴³ Asquith, M. E. (2015, July 17). FINRA Letter on Proposed Conflict of Interest Rule and Related Proposals [Letter to Employee Benefits Security Administration], available at: <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB32-2/00405.pdf>

communicate with compensation systems, holding detail about the compensation received by the firm and financial advisor. In the event information is not available internally, the process would have to accommodate receiving it from external vendors. Spending resources to create these systemic connections or accessing information from a third party is an additional cost, increasing the costs of compliance for financial institutions, which may ultimately be borne by retirement investors.

The on-demand requirement also creates a need for the financial institution to retain and store information related to each trade because the retirement investor has the right to request it for a period of up to six years after the trade. Financial institutions will need to store all the relevant data because fees change and investments evolve. Financial institutions will need to be prepared simply because a retirement investor *might* make such a request. This creates unnecessary costs for the financial institution and may create additional costs to retirement investor in support of their accounts.

Because it is likely to lead to increased costs which will be borne by retirement investors and create disruption in the industry, the requirement for on-demand transaction disclosure should be removed from the exemption conditions.

The web page requirement. The BIC exemption requires the financial institution to maintain a web page that lists all “direct or indirect material compensation” payable to the advisor for services in connection with each asset (or, if uniform across a class of assets, the class of assets) that an investor is able to purchase, hold or sell through the advisor and that has been purchased, held or sold in the last 365 days, along with the source of the compensation and how it varies within and among assets. This presumably requires the detailing of every insurance company separate account, every collective trust by unit class, every mutual fund by share class, every annuity contract, among other data.

While the Department made some changes to this section, including removing the requirement that the data be provided in a machine readable format, SIFMA continues to view the web page disclosure requirement as overly broad, very impractical, and extremely costly and cumbersome to build, administer and maintain. The requirement is effectively a thinly veiled aid to plaintiff’s lawyers everywhere. Indeed, the Department admits to this goal, stating that a related goal is to provide information that enables “financial information companies” to analyze and compare fee and compensation practices of advisors and financial institutions. We simply do not see how establishing a publicly available web page would serve the interests of the public or the individual investor. It does not appear to be designed as or intended to be participant helpful disclosure. It should be eliminated, along with the BIC exemption’s required contractual commitments that encourage private litigation.

Requirements to sell proprietary products and funds that pay third party fees.

Another very impractical and unnecessary provision of the BIC exemption relates to Section IV, which permits the financial institution to offer only proprietary products, only those that generate third party fees or only those of a particular asset class or product type, if it makes a written finding that the limitations do not prevent the advisor from providing advice that is in the investor's best interest. This provision is a means to cause financial institutions to stop selling funds that pay third party fees and to stop selling proprietary products. The number of requirements, often duplicative of other requirements, coupled with the findings required and the standard financial institutions are required to meet in recommending a product that pays third party fees, or a proprietary product, make it nearly impossible for a financial institution to meet the terms of this section of the exemption. For that reason, there are many institutions considering not selling their proprietary products to retirement investors, while limiting their mutual fund offerings to those that have identical third party payments.

Cost of the Rule and its Accompanying Exemptions

This rule will have significant costs for both consumers and institutions. New research from the American Action Forum (AAF) highlights that the Rule was the most expensive regulation of 2016, and the second most expensive non-environmental rule since 2005.⁴⁴ The report found that the Rule has the potential to increase consumer costs by \$46.6 billion, or \$813 annually per account. The AAF found that the Rule could force 28 million Americans out of managed retirement accounts entirely if, for example, financial institutions choose to move to a primarily fee-based platform for accounts with an estimated minimum balance requirement of \$30,000. If that minimum account balance were lowered even to \$5,000, over 13 million would still lose access to managed retirement accounts.

Across the industry, firms have already spent billions to comply with the Rule, and it is estimated that billions more will be spent readying for the new June 9, 2017 and January 1, 2018 compliance deadlines if the Rule goes into effect as written. A report by A.T. Kearney highlights the enormous impact of the Rule on the industry, noting that "significant asset shifts" will occur and "industry players will be affected at all levels." The report notes that substantial up-front and ongoing investments will be needed to ensure compliance, including technology, legal expenses, process changes, education, and training. *See* Appendix III. Furthermore, wealth management firms covered under the Rule will see estimated annual litigation costs up to \$150 million as a result of class-action lawsuits and opportunity costs.⁴⁵ Many mutual fund companies have already gone to the

⁴⁴ AAF. "The Consequences of the Fiduciary Rule for Consumers" (Apr. 10, 2017), available at: <https://www.americanactionforum.org/research/consequences-fiduciary-rule-consumers/>

⁴⁵ *Id.*

expense of creating a new class of shares that will allow financial institutions to sell a variety of funds whose costs and attributes are identical, thereby minimizing the conflicts inherent in selling products with different selling costs, both at the financial institution and the financial advisor level. If the Rule and its accompanying exemptions are rescinded or changed – which we certainly hope and believe should be the case – many of these costs will have been unnecessary. As we said at the outset, we urge the Department to avoid requiring financial institutions to incur still more costs until a path forward is clear.

While we understand that the Department’s staff has enormous time and effort invested in the Rule, it may be that they are too close to their approach to see the adverse effects that the Rule has had on participant choices, the trend toward advisory accounts, the abandonment of smaller accounts to the internet, the severe restriction of investor choice due to the decrease in services and increase in prices to retirement savers and the probability of a huge increase in litigation.

In SIFMA’s view, this Administration has the obligation to carry out its stated intention to take those actions necessary to avoid inconsistent or duplicative regulation that ultimately places unnecessary and costly burdens on firms and their customers and reconsider whether this primarily retail issue should be the responsibility of the SEC and FINRA rather than vesting authority for IRAs and other non-ERISA accounts in the Department. Many of our members believe that these rules demonstrate that the Department neither understands the financial markets nor the costs and adverse effects of its upheaval of this industry. In our comments on the proposal, we pointed out that the costs to the industry of complying with the BIC exemption would cause a wholesale shift to advised accounts, a loss of services to small accounts, and confusion and panic among customers with small accounts, who are being notified that their accounts will be required to move from the brokerage setting, or their mutual fund and other investment choices are being significantly altered. The Department, to the extent it acknowledged these adverse effects, substituted its judgment for that of millions of retirement investors, and said it would be better for them. In light of the business model changes of much of the industry over the last 12 months, one would be compelled to reach a different conclusion.

The Department’s Economic Analysis

The basis for the Department’s cost benefit analysis is too old to be reliable and it has been misapplied by the Department. It was outdated when used, and in light of the huge changes being contemplated in the market – significant movement to advisory accounts, T shares, clean shares and other reductions in mutual fund fees generally – the Department’s analysis will only lead to flawed results. It fails to correct errors when the studies it relies on are updated or corrected. It fails to recognize retirement investor harm from lack of

access to advice, reduced investment in equities, lack of guaranteed lifetime income, lack of disability income or long term care insurance. All of these building blocks are the foundation of a solid financial future during retirement. The inability to have a frank conversation about all of these issues will surely result in a less secure retirement.

The Department did not consider in its calculation the additional costs investors who seek advice will bear from moving to fee-based advised accounts or the costs of mistakes that investors who lose advice will make. Intermediaries have announced a variety of changes to service offerings, including no longer offering mutual funds in brokerage IRA accounts and raising account minimums or discontinuing advisory services and commission-based arrangements for lower balanced accounts. As the Investment Company Institute has pointed out, new economic studies estimate that investors could lose \$109 billion over 10 years because of the Rule's implementation. This would amount to \$780 million per month in losses to investors. A 60-day delay would thus save investors \$402 million in lost returns over 60 days. A 180-day delay would save more than \$1.2 billion. Even a 60-day delay would amount to \$414 million in lost returns saved for investors over the first year if the Rule ultimately goes forward as now structured and \$542 million over a 10-year period (at a three percent discount rate). These lost returns far exceed the Department's estimated \$104 million losses in the form of foregone gains—gains that, as shown above, are widely overstated.⁴⁶

Furthermore, the underlying data the Department relied upon from the Council of Economic Advisers (CEA) report is not justified. The NERA Economic Consulting 2015 analysis showed that the \$17 billion estimate in the CEA study was flawed. It was based on a study comparing broker-sold to direct channel mutual funds relative underperformance of 110 bps – but the CEA had no basis to extrapolate from this single study on a small portion of the market for retirement assets and apply it to all IRA assets, including products like variable annuities that were not even studied in the CEA report.

Since this time, the author of a CEA cited paper has updated his analysis with more recent data -- and reduced his estimate of underperformance by over one third.⁴⁷ This update alone would dramatically slash the CEA's loss estimate, but this big change also shows the lack of robustness in the CEA approach.

NERA also noted that the CEA analysis completely disregards the benefits of advice to consumers, with brokers helping customers understand the long-term benefits of

⁴⁶ Investment Company Institute, March 17, 2017, submission to the Department of Labor on the proposed delay to the applicability date, available at: https://www.ici.org/pdf/17_ici_dol_fiduciary_applicability_ltr.pdf

⁴⁷ Reuter, Jonathan. "Revisiting the Performance of Broker-Sold Mutual Funds." (2015). Found at https://www2.bc.edu/jonathan-reuter/research/brokers_revisited_201511.pdf

retirement saving and avoiding panic/irrationality in their investment decisions. The Department's own study showed benefits of \$114 billion to consumers from having advice on retirement savings, benefits that dwarf their claim of the costs of conflicted advice.⁴⁸ The Department erroneously concluded that the problem that "needs fixing" is broker-sold funds. It did not look at leakage, the potentially higher cost of advisory fees for some clients, or the cost of abandoning retirement investors with no financial planning or investment advice and virtually no retirement planning education.⁴⁹

Plain and simple, the Department set out to make broker sold funds difficult, if not impossible, to sell under the only exemption that it allowed to remain in place for brokerage accounts after the applicability date. It hardly considered all the other investment products that retirement investors have chosen to buy and it did not consider at all the effect of these rules on the market for those products. That bias runs through its economic analysis, and indeed through its proposal to delay the applicability date. Its conclusion is driven by bad data, old data, and a stubborn refusal to look at changes in the marketplace since 2012. Even the Department, despite clinging to outdated studies, acknowledged that the 2016 RIA's conclusion that broker-sold funds "underperform" is based on a limited assessment "of one source of conflict (load sharing) in one market segment (IRA investments in front-load mutual funds)." Having acknowledged that limitation, it refused nonetheless to consider other data.

The Department's conclusion of underperformance in the range of 50 to 100 bps suffers from the fact that the one negative effect it claims to show, significant poor mutual fund selection by brokers, is not supported by the very academic studies on which it relies. ICI's original comment letter to the Department identified several significant flaws in the RIA supporting the proposed Rule. Rather than conducting its own investigation of current, publicly available data to assess how the Rule might affect fund investors, the Department turned to academic studies in an effort to find evidence supporting its rulemaking. Commenters, including SIFMA and the ICI, identified several problems with the Department's application of the findings in such studies.

First, one would assume that the Department would analyze the benefit of working with a broker not subject to this Rule, rather than the limited and restricted investment advice should this Rule go in place. However, not a single study relied on by the Department addressed this central issue. Do retirement investors in asset based fee accounts where neither the financial institution nor the financial advisor have conflicts do

⁴⁸ Investment Advice – Participants and Beneficiaries; 76 Fed. Reg. 66136, (Oct. 25, 2011), available at: <http://webapps.dol.gov/FederalRegister/PdfDisplay.aspx?DocId=25414>

⁴⁹ While the Department has provided an exception for education, most firms have concluded that the litigation risk of the plaintiff's bar claiming that education was really advice is too great in a one on one conversation setting. Thus, it seems inevitable that education will suffer.

better than retirement investors in a brokerage setting? The Department does not know the answer to that question, and did not try to find the answer to that question, although surely it is central to any appropriate analysis. None of the academic studies relied on by the Department addressed this issue. Thus, as the ICI pointed out, the findings of underperformance cited in the 2016 RIA do not actually measure—and cannot measure, based on these studies—whether an investor using a fee-based ERISA fiduciary advisor would experience a different investment outcome than an investor using another financial advisor that is not an ERISA fiduciary. Instead, these studies look at only one factor -- the performance of funds sold through brokers (“broker-sold” funds) with that of funds sold directly to investors (“direct-sold” funds). The Department erroneously substitutes the results of that comparison for the answer to the only question that matters: do retirement investors do better with a fiduciary advisor? The Department refuses to acknowledge that financial institutions are far more likely to comply with the Rule through fee based accounts rather than taking on the legal risk, cost, and business model gymnastics of complying with a Rule that reflects how the Department’s ideal broker-dealer should run its business. At this point, we estimate that a significant portion of accounts, largely under \$50,000, will move from a setting where they can sit down one on one with a financial professional, to call centers and the internet where no advice will be provided. That is not to say that some financial institutions will not agree to give advice through a call center or through the internet using the BIC exemption; it is only to say that where financial institutions do not choose to use the BIC exemption, retirement investors may be left without advice. This is not a new issue for SIFMA and its members; now however, we can point to the fact that this shift has become reality.

Reliance on the studies on which the Department’s Rule and its accompanying exemptions was based ignores substantial changes in the mutual fund markets that have led to significant head-to-head competition between broker-sold funds and no-load funds. For example, in 2000 only about half of the funds with a front-end load share class also had no-load share classes. By 2010, though, 90% of funds with a front-end load share class also offered a no-load share class. These no-load share classes are available on investment-only 401(k) platforms, at discount brokerages, and through fee-based advisory firms. This head-to-head competition between broker-sold funds and no-load funds has transformed the market for mutual funds. The Department’s studies ignore this shift.

See, for example, a paper by Jonathan Reuter, who revisits the performance of broker-sold and direct-sold mutual funds using distribution channel data that cover 2003–2012.⁵⁰ His conclusion is that “the average broker-sold fund has become more competitive with the average direct-sold fund.” He reports that the broker-sold funds underperformed

⁵⁰ Reuter, Jonathan. "Revisiting the Performance of Broker-Sold Mutual Funds." (2015). Found at https://www2.bc.edu/jonathan-reuter/research/brokers_revisited_201511.pdf

direct-sold funds (measured across all types of actively managed funds excluding municipal funds and adjusting for 12b-1 distribution fees) by only 18 bps over the period 2003–2012 on an asset-weighted basis. This is less than one-fifth of the 100 bps underperformance assumed in the 2016 RIA. As SIFMA pointed out in its 2011 and 2015 comments, the Department chose to rely on outdated and incorrect data because it was easier than collaborating in a reasonable manner with the industry to try to obtain more current and accurate data.

Since the studies the Department did rely on have been shown to be inaccurate, all of the Department's conclusions should be reassessed. Its estimate that investors in front-end load funds will lose \$500 billion to \$1 trillion in foregone returns during the next 20 years is simply wrong. Moreover, the Department found no study that estimated the cost of private litigation inherent in the use of the BIC exemption. Morningstar estimates that number at \$70-150 million annually, and many multiples of that estimate in the early years. For large firms, Morningstar estimates the costs of compliance at four times the Department's estimates. Moreover, it doesn't answer the central question: will retirement investors left to the internet or in advised accounts do better? We think not, particularly as it relates to execution only internet or call center services.

In 2011, the Department estimated that consumers who invest without professional advice make investment errors that collectively cost them \$114 billion per year. Applying the Department's own logic to the present proposal, combined with the likelihood that a large number of investors will lose access to advice, we think that the resulting aggregate retirement investor costs may exceed the Department's own estimates of the retirement investor benefits of the proposal. The benefits of working with financial advisors have been generally ignored in the Department analysis. A range of peer-reviewed academic and industry studies provide clear evidence as to the value of advisors in a number of areas, including avoiding home bias, avoiding stock-picking and excess trading, holding more diversified portfolios, encouraging equity market participation, investing in a more tax-sensitive way, optimizing withdrawal strategies, reducing cash drag, and avoiding behavioral mistakes.

Using a \$2 trillion asset base consistent with the assumption used in the Rule's calculation of investor gains in the mutual fund segment, the ICI quantified the cost to investors if they are no longer able to receive proper investment advice and guidance due to perceived conflicts. This analysis, along with the peer-reviewed methodology that forms the basis for these estimates, is as follows:

1. Aon Hewitt, "Advice in Defined Contribution Plans: 2006 Through 2010," 2011.

Through the analysis of 425,000 401k plan participants, this study found a performance gap of 2.92% between advised versus non-advised participants,

or **\$600bn of investor gain over 10 years and \$1,200bn of investor gain over 20 years**. Importantly, this study found near-retirees not using advice showed trading activity in 2008 that led to significantly worse investment performance results in 2009.

2. Blanchett, David and Paul Kaplan, "Alpha Beta and Now... Gamma," Journal of Retirement, Fall 2013, Vol. 1, No. 2, pp 29-45.
Advisor value estimate of 1.59% per year, or **\$318bn of investor gain over 10 years and \$636bn of investor gain over 20 years**.
3. Francis M. Kinniry Jr., CFA, Colleen M. Jaconetti, CPA, CFP®, Michael A. DiJoseph, CFA, Yan Zilbering, and Donald G. Bennyhoff, CFA, "Putting a value on your advice: Quantifying Vanguard Advisor's Alpha" Vanguard research, September 2016.
Advisor value estimate of 3% per year, or **\$600bn of investor gain over 10 years and \$1,200bn of investor gain over 20 years**.
4. Montmarquette, Claude and Nathalie Viennot-Briot. "The Value of Financial Advice," Annals of Economics and Finance, 16-1, 69-94 (2015).
After controlling for close to 50 variables, finds that households working with advisors have 58%, 99%, and 173% greater assets, when compared to unadvised households, after working with the advisor for 4-6 years, 7-14 years, and 15+ years, respectively.
5. Montmarquette, Claude and Nathalie Viennot-Briot. "The Gamma Factor and the Value of Financial Advice," Working paper.
This study finds that dropping a financial advisor between 2010 and 2014 resulted in households losing 34% of their assets compared to a gain of 26% for households that retained their advisor.

Studies show that unadvised households tend to hold fewer equities than advised households.⁵¹ The likelihood of owning any stocks or stock-based mutual funds increases by 67% with the use of an advisor and the proportion dedicated to stock positions increases by 39%. Academic work clearly shows that asset allocation, not mutual fund selection, explains, on average, 100% of performance⁵². If the Rule results in a reduction of equity

⁵¹ Foerster, S.R., Linnainmaa, J., Melzer, B., Previtro, A., (forthcoming), "Retail Financial Advice: Does One Size Fit All?" Journal of Finance.

⁵² Ibbotson, Roger G. and Kaplan, Paul D., Does Asset Allocation Policy Explain 40, 90, 100 Percent of Performance? Financial Analysts Journal, Jan/Feb 2000, Vol. 56, No. 1. Available at: <https://ssrn.com/abstract=279096>

allocations by only 15%, the ICI estimated that would result in a performance decline of 50-100 bps per year, on average, **or \$95 billion and \$189 billion over the next 10 years and between \$202 billion and \$404 billion over the next 20 years.**

Another potential limitation in the Department cost/benefit analysis is the extent to which the imposition of the Rule could undermine advice and product innovation on a number of fronts. The impact is difficult to quantify, but fiduciary concerns are a primary reason 401(k) sponsors generally don't offer post-retirement solutions.⁵³

Lastly, there appears to be scant attention paid to the impact that increased litigation (or the threat of increased litigation) can have upon investment performance. It will impact investors in two possible ways. First, the increased cost will be redistributed back to clients. Second, advisors and firms will become risk averse and will dramatically reduce choice to minimize and suppress litigation cost. Some firms have already announced that they will no longer allow their financial advisors to give advice to retirement brokerage accounts (leaving such retirement investors to fend for themselves) as a response to the Rule and the complexities associated with the BIC exemption. This suggests that the portfolio costs could be material and perhaps even outweigh any assumed "conflict elimination" benefits.

Other Issues Raised by the Department

The Department asks whether revenue sharing, principal markups and markdowns, excessive or poorly timed trading, and conflicts in annuity sales constitute potential negative effects of the proposed delay and what is the degree to which they cause the cost illustration to overstate or understate the potential negative effect of the delay on retirement investors. As noted elsewhere in this comment letter, the Department's claims of excessive or poorly timed trading are alleged by it, but no evidence is provided. We have addressed elsewhere in this comment the Department's cost illustration and its flaws. We point out, however, that the Department has no evidence of excessive or poorly timed trading in the retirement world, and thus assuming it exists and will stop is inaccurate and materially misleading.

The Department also asks whether the benefit of the delay to the industry justifies its costs to retirement investors. As we have pointed out elsewhere in this comment letter, we believe, based on the changes in offerings to retirement investors that will likely occur when the Rule take effect, the benefit to retirement investors, when coupled with the

⁵³ Aon-Hewitt, "2016 Hot topics in retirement and financial well-being," available at: <http://www.aon.com/attachments/human-capital-consulting/2016-hot-topics-retirement-financial-wellbeing-report.pdf>

benefit to the industry, outweigh significantly any effect from further delay in the applicability of the Rule. As SIFMA has noted throughout this comment, while a best interest standard is more than overdue for personalized investment advice, the Department's method of implementing it, assuming for the sake of argument that it is in the best position to propose or implement it, is the wrong direction.

The Department notes that it found that the final Rule will move markets toward a more optimal mix of advisory services and financial products. First, what is more optimal in the Department's view is merely social engineering, substituting its view for that of millions of retirement investors. All of those investors could have moved to the Department's optimal low fee, index fund solution at any time over the last 10 years, and despite its heavy hand on the scale, and the widespread availability of these funds, many retirement investors have chosen not to do so. We emphasize the word **choice**; the Department wants to remove choice and has effectively done just that with this Rule. The study mandated by the President should admit that aim and concede that restrictions on choice is, in fact, the result of this Rule. The Department has done its best to make retirement investors' current choices unavailable to them. In response to the Department's question on the Rule's effect on investor access to quality, affordable investment advice services and investment products, including small investor access, we note that at any time, small investors or large investors can open IRAs at low cost index fund providers. Many have done so; many have chosen not to do so. We reiterate that it is not for the Department to make their choices unavailable, and to force them into solutions they do not select, simply because the Department believes that these choices are better.

The Department asked for comment on a variety of effects of the Rule thus far. Many firms have already implemented changes that will limit choices for retirement investors and those changes will be rolled out on June 9, 2017, if not before. Others are considering such changes and will likely announce them within a few months. Once they are put in effect, we think there is wide-scale agreement that the smallest accounts will see the greatest changes in the products and services available to them. And, since these small investors are the very ones who most need one on one conversations on planning for retirement, we fear that the effect on them will be the most long-lasting and the most adverse.

Elsewhere in this comment letter, we have provided some insights into how financial institutions have been planning to comply with the Rule if it becomes effective without change. As noted throughout, we think there will see a significant shift to advisory accounts for medium to large retail accounts and with respect to small accounts, we expect to see a significant movement to call centers or the internet, where no advice or financial education whatsoever will be available. For financial institutions that choose to use a "Country Trust" approach approved in DOL Advisory Opinion 2005-10, clients will see higher asset-based fees in their accounts, subject to offset from 12b-1 fees and revenue

sharing. But to participants and retirement investors, it will appear to be a significant increase, since their accounts were not previously being charged an asset based fee.

The Department asked for comments on changes to the way advisors will be paid. For those institutions complying with the BIC exemption, while some firms have been in the process of developing mechanisms to comply, most firms have not finalized how they will comply since they still need clarity and finality to complete and implement their plans. For financial institutions using the Country Trust approach, or switching to advisory programs, the advisors will be paid a percentage of asset-based revenue which should mitigate conflicts. We think, however, the move away from straight commission pricing will be significant.

Elsewhere in this comment, we have discussed changes in minimum balance requirements for both brokerage and asset based fee products, the difficulties in complying with the BIC exemption and the costs of doing so, including the expected cost of litigation. We have discussed our members' concerns that education and advice to low income, low account balance retirement savers will surely suffer, and the financial literacy problems, the investment paralysis, the flawed asset allocation, and the precipitous response to market events, all of which have been documented in academic studies as being damaging to investors' best interests, will become worse.

Finally, throughout this comment we have made clear that the Department's preferred method of enforcement through private plaintiff's lawyers will cause the majority of the industry to avoid using any structure that relies on the BIC exemption, or where it is used, to limit the available investment products and choices. We urge the Department to take a fresh look at the way the industry is moving in response to its Rule, and the effect those changes in business models and fees will affect retirement savers.

A Better Solution

SIFMA strongly supports enhancing investor protections by establishing a heightened and more stringent best interest standard of conduct for broker-dealers when providing personalized investment advice. In fact, for over eight years and counting – predating both the passage of the Dodd-Frank Act and the Department's Rule, SIFMA has strongly supported SEC action to establish a uniform fiduciary standard for broker-dealers and investment advisers when providing personalized investment advice about securities to retail customers.⁵⁴

⁵⁴ See, e.g., SIFMA comment to SEC re: Dodd-Frank Section 913 study (Aug. 2010), available at: <http://www.sifma.org/issues/item.aspx?id=22263>; SIFMA/Oliver Wyman study on the prospective impact of

While there remains work to be done by the SEC in this important area, it is worth noting that the rules and precedents governing broker-dealers' conduct with respect to retail investors, both in retirement and non-retirement accounts, have been steadily migrating toward a best interest standard in recent years. FINRA, on behalf of the SEC, has been increasingly refining its definition of suitability under Rule 2111 and most recently through guidance related to 401(k) and similar plan rollovers under Regulatory Notice 13-45 to require brokers to put clients' best interests ahead of their own. Moreover, investor claims in FINRA arbitrations routinely include a fiduciary duty claim.

The best interest standard contemplated by SIFMA would apply across *all* personalized securities recommendations made to retail customers in *all* broker-dealer accounts (not just limited to IRA accounts). Moreover, it would build upon, and fit seamlessly within, the existing and long-standing securities regulatory regime for broker-dealers, coupled with robust examination, oversight, and enforcement by the SEC, FINRA and state securities regulators.

Our proposed standard would share all of the hallmarks of the Department's best interest standard, including prudence and putting the client's interest in front of the advisor's interest, while avoiding its significant shortcomings, including the overly broad conditions, unnecessary subjectivity, and overlapping and expensive requirement currently contained in the Rule, and particularly the BIC exemption.

Notwithstanding the well-meaning intentions of the Department, we believe this Rule and its accompanying exemptions would result in bifurcated and conflicting standards among a financial institution's clients, redundant compliance regimes and unnecessary investor confusion and cost. SIFMA supports a strong, SEC-mandated substantive best interest standard that applies across all personalized investment recommendations made to

a uniform fiduciary standard (Nov. 2010), available at: <http://www.sifma.org/issues/item.aspx?id=21999>; SIFMA/Oliver Wyman study, supplemental comment (Nov. 2010), available at: <http://www.sifma.org/issues/item.aspx?id=22336>; SIFMA comment to FINRA re: FINRA Regulatory Notice 10-54 (Dec. 2010), available at: <http://www.sifma.org/issues/item.aspx?id=22482>; SIFMA comment to SEC re: proposed framework for rulemaking under Section 913 (Jul. 2011), available at: <http://www.sifma.org/issues/item.aspx?id=8589934675>; SIFMA testimony before a U.S. House panel on broker-dealers and investment advisers (Sep. 2011), available at: <http://www.sifma.org/issues/item.aspx?id=8589935390>; SIFMA comment to SEC re: financial literacy among investors (Mar. 2012), available at: <http://www.sifma.org/issues/item.aspx?id=8589938025>; SIFMA supplemental comment to SEC re: proposed framework for rulemaking under Section 913 (May 2012), available at: <http://www.sifma.org/issues/item.aspx?id=8589938634>; SIFMA testimony before U.S. House Financial Services Committee on the Investment Advisers Oversight Act (Jun. 2012), available at: <http://www.sifma.org/issues/item.aspx?id=8589938957>; and SIFMA comment to SEC re: request for cost-benefit data (Jul. 2013), available at: <https://www.sifma.org/issues/item.aspx?id=8589944317>.

individual retail customers in all investment accounts, not just limited to retirement accounts.

If you have any questions on these comments, please contact me at (202) 962-7329.

Sincerely,

A handwritten signature in cursive script that reads "Lisa J. Bleier".

Lisa J. Bleier
Managing Director and Associate General Counsel

Appendix I

Potential DOL Action on the Fiduciary Rule under Secretary Acosta

Alan Charles Raul
Maureen B. Soles
April 17, 2017

This memorandum analyzes certain Administrative Procedure Act (“APA”) issues with respect to the new Administration’s review of the Department of Labor’s (“DOL”) regulation redefining the term “fiduciary” (“Fiduciary Rule” or “Rule”). Specifically, this memorandum considers what process the DOL could follow to extend implementation of the Fiduciary Rule for an additional review period, and to withdraw and permanently rescind, maintain, or revise the current Rule.

Pursuant to President Trump’s directive that DOL should review the Fiduciary Rule,¹ DOL must engage in a detailed review of the existing Rule. Such review must comply with APA requirements. Since the existing Rule was adopted pursuant to notice-and-comment rulemaking, reconsideration of the Rule will require collection and analysis of existing and additional comments from the interested public, followed by careful legal and policy deliberation by the new Administration. This review and reconsideration process will require considerable time given the complexity of the issues. Accordingly, further extension of the Rule’s implementation will be necessary for DOL to discharge its obligation to assure “reasoned decisionmaking” under the APA.²

This substantial reconsideration is entirely proper. The new Administration is entitled to review and revise the policy choices embedded in a regulation issued by its predecessor. Indeed, as the Supreme Court held in *Chevron*, “an agency to which Congress has delegated policy-making responsibilities may, within the limits of that delegation, properly rely upon the

¹ See Presidential Memorandum on Fiduciary Duty Rule, Exec. Order No. 13772 of Feb. 3, 2017, 82 Fed. Reg. 9,965 (Feb. 8, 2017), <https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-memorandum-fiduciary-duty-rule>.

² The Consumer Federation of America, a group opposing any delay of DOL’s Fiduciary Rule, conceded that “[w]e agree that the analysis required by the Presidential Memorandum will be time-consuming to complete – indeed will take far longer than has been allowed for it [in DOL’s initial delay of the applicability date]. . . .” Consumer Federation of America, Comment Letter on Proposed Rule Regarding the Definition of the Term “Fiduciary” (Mar. 17, 2017), <http://consumerfed.org/wp-content/uploads/2017/03/3-17-17-CFA-DOL-Fiduciary-Delay-Proposal-Comment.pdf>. Indeed, in 2015, the Obama Administration recognized the importance of taking time on this rulemaking. See Definition of the Term “Fiduciary”; Conflict of Interest Rule—Retirement Investment Advice, 80 Fed. Reg. 21,928, 21,936 (April 20, 2015) (“After consideration of these comments and in light of the significance of this rulemaking to the retirement plan service provider industry, plan sponsors and participants, beneficiaries and IRA owners, the Department decided to take more time for review and to issue a new proposed regulation for comment.”).

incumbent administration’s views of wise policy to inform its judgments.”³ The new Administration’s ability to change policy course in the present circumstances is buttressed by the fact that there is neither a relevant congressional deadline by which it must act, nor any specific statutory direction that mandated the particular policy choices of the prior Administration. Nonetheless, if DOL ultimately determines that the Fiduciary Rule should be rescinded, maintained, or revised, following a proposal to withdraw the Rule, DOL should explicitly acknowledge that it is changing course and provide a reasoned explanation for its new determination.

DOL’s actions with respect to the Fiduciary Rule should conform to its request for public comments issued on March 2, 2017. That request sought comments with respect to each of the following expressly identified possible actions: a “proposed 60-day delay of the applicability date, on the questions raised in the Presidential Memorandum, and generally on questions of law and policy concerning the final rule and [prohibited transaction exemptions].”⁴ DOL will have received substantive comments on each of these options by April 17, 2017, and will thereafter be in a position to take action in accordance with its assessment of the comments.

Accordingly, following its review of the current set of comments, DOL may take the following actions:

- (1) Issue an interim final rule⁵ for “good cause” extending the applicability date of the Fiduciary Rule for 180 days provided DOL:
 - a. Makes a finding that, given the notice already provided and comments received, further notice and solicitation of comment regarding the extension of the applicability date are “impracticable, unnecessary, or contrary to the public interest,” and that an orderly reconsideration of the Rule over a sufficient period of time would reduce confusion, uncertainty, and disruption for the industry and investors;
 - b. Accounts for its changed view of the assessment of the costs of delay beyond the 60-day delay contained in the April 7 Delay Rule;
 - c. Indicates that DOL intends to publish a proposed rule that solicits public comments on whether DOL should (1) let the Rule become effective, (2) withdraw the Rule, or (3) revise the Rule; and

³ *Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 857-858, 865 (1984) (sustaining the EPA’s revised definition of the term “source” which the agency undertook pursuant to the new administration’s “Government-wide reexamination of regulatory burdens and complexities”).

⁴ Definition of the Term “Fiduciary”, 82 Fed. Reg. 12,319, 12,325 (Mar. 2, 2017).

⁵ See Office of the Federal Register, “A Guide to the Rulemaking Process,” https://www.federalregister.gov/uploads/2011/01/the_rulemaking_process.pdf (“When an agency finds that it has good cause to issue a final rule without first publishing a proposed rule, it often characterizes the rule as an “interim final rule,” or “interim rule.” This type of rule becomes effective immediately upon publication.”).

- d. Indicates that interested parties may provide comments on the 180-day delay during an appropriate comment period following publication regarding the additional delay, which DOL can take into account and which could lead DOL to revise the delay period as appropriate.
- (2) DOL should issue a notice of proposed rulemaking (“NPRM”) within 180 days regarding whether DOL should (1) withdraw the current Fiduciary Rule, (2) revise the Fiduciary Rule, or (3) allow the current Rule become effective. DOL should provide interested parties with at least a 30-day comment period and indicate that it intends to issue a final Rule as soon as practicable.⁶
 - (3) If, following notice and comment on agency action described above, DOL ultimately determines to permanently rescind or maintain the Fiduciary Rule, DOL may proceed to a final rule to that effect. If DOL determines to revise the current Rule based on its assessment of all comments received and upon its policy reconsideration, DOL should issue a supplemental NPRM setting forth its proposed revisions for comment from all interested parties.

In issuing the interim final rule extending the applicability date, DOL should acknowledge the significant public interest in the Fiduciary Rule, the substantial comments submitted in response to the agency’s March 2 NPRM regarding the substantive review of the Fiduciary Rule, and the importance of minimizing harm to all participants in the relevant marketplace—including, of course, investors and regulated entities. As a result, DOL could determine that the initial delay of 60 days was inadequate to consider all the comments received and make an informed policy decision regarding the Rule. The 180-day extension should also be predicated on a finding that substantial additional time is necessary to reduce confusion, uncertainty, and disruption for the industry and investors while DOL determines the appropriate final disposition of the Fiduciary Rule, while also permitting DOL sufficient time to reconsider the Rule commensurate with its complexity.

DOL could find that, to the extent 5 U.S.C. § 553(b)(A) applies to its action to extend the applicability date of the Fiduciary Rule, DOL is exempt from notice and comment rulemaking for “good cause” and justified under the exceptional circumstances presented here. To begin, DOL had previously provided express notice and sought comments on extending the Rule’s applicability date and the public suggested that 60 days would likely be inadequate to reconsider the Rule.⁷ In addition, the delay will preserve the status quo, as many of the legal requirements have not yet gone into force, and will prevent potentially disruptive regulation that the new Administration is reconsidering. Finally, the new Administration’s agency head will not have an opportunity to adequately consider the Rule, required by a specific Presidential directive, prior to

⁶ To the extent DOL does not issue its final rule sufficiently in advance of the applicability date set out in the interim final rule, DOL would need to take appropriate action to further extend the rule.

⁷ See Consumer Federation of America, Comment Letter on Proposed Rule Regarding the Definition of the Term “Fiduciary” (Mar. 17, 2017), <http://consumerfed.org/wp-content/uploads/2017/03/3-17-17-CFA-DOL-Fiduciary-Delay-Proposal-Comment.pdf> (“We agree that the analysis required by the Presidential Memorandum will be time-consuming to complete – indeed will take far longer than has been allowed for it [in DOL’s initial delay of the applicability date]....”).

the applicability date. As the Rule is not subject to any congressional deadline or specific statutory dictates, “good cause” should excuse notice and comment.

Significantly, all sides to the debate appear to acknowledge that, given the intricate policy judgments and economic impacts involved, getting the substance of this regulation right warrants extensive deliberation. By adopting an interim final rule that delays the applicability date of the Rule for 180 days, which DOL could revise in response to comments received, DOL could review and consider the policy justifications for the Fiduciary Rule in compliance with the APA.

I. Background on the Fiduciary Rule

In 2015, the DOL published a notice proposing to revise the agency’s five-part test for determining when a person “renders investment advice” and the prohibited transaction exemptions.⁸ Following a notice and comment period, the DOL published its final rule, the Fiduciary Rule, on April 8, 2016.⁹ The original rule was effective on June 7, 2016, but its legal requirements would not go into force until the “applicability date” of April 10, 2017.¹⁰

On February 3, 2017, President Trump directed the DOL to “examine the Fiduciary Rule to determine whether it may adversely affect the ability of Americans to gain access to retirement information and advice.”¹¹ On March 2, 2017, DOL issued a NPRM to extend for 60 days the applicability date of the Fiduciary Rule.¹² In the same NPRM, DOL requested comments on “the questions raised in the Presidential Memorandum, and generally on questions of law and policy concerning the final rule and PTEs.”¹³ The comment period on delaying the applicability date closed on March 17, 2017.¹⁴ The comment period on the substantive review of the rule remains open until April 17, 2017.¹⁵

On April 7, 2017, after considering public comments on whether the Fiduciary Rule should be delayed, DOL published a final rule delaying the applicability date of the Fiduciary Rule for sixty days, until June 9, 2017.¹⁶

II. APA Process

The APA prescribes the procedures an agency must use for “rulemaking,” defined as the process of “formulating, amending, or repealing a rule.” 5 U.S.C. § 551(5). When an agency

⁸ 80 Fed. Reg. at 21,932.

⁹ Definition of the Term “Fiduciary”; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. 20,946 (Apr. 8, 2016).

¹⁰ *Id.* at 20,946.

¹¹ 82 Fed. Reg. at 9,965.

¹² 82 Fed. Reg. at 12,319.

¹³ The comment period on this substantive question remains open until April 17, 2017. 82 Fed. Reg. at 12,319.

¹⁴ 82 Fed. Reg. at 12,319.

¹⁵ *Id.*

¹⁶ Definition of the Term “Fiduciary”, 82 Fed. Reg. 16,902 (Apr. 7, 2017). The Rule also delayed applicability of certain aspects of various exemptions by 60 days and delayed applicability of certain other aspects and amendments of various exemptions until January 1, 2018. *Id.*

promulgates a so-called legislative rule,¹⁷ it must follow the rulemaking procedures outlined in § 553. An agency is required to provide the public with adequate notice of a proposed rule followed by a meaningful opportunity to comment on the rule’s content. § 553(b)(1)-(3). Specifically, the APA requires that the notice of proposed rulemaking include “(1) a statement of the time, place, and nature of public rule making proceedings; (2) reference to the legal authority under which the rule is proposed; and (3) either the terms or substance of the proposed rule or a description of the subjects and issues involved.” *Id.*

The APA, however, explicitly waives the notice and comment requirement in various situations, including for “(A) ... rules of agency organization, procedure, or practice; or (B) when the agency for good cause ... finds ... that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.” § 553(b)(A)-(B).

The “good cause” exemption is appropriate when “(1) advance notice of rulemaking will defeat the regulatory objective, (2) immediate action is necessary to reduce or avoid health hazards or imminent harm to persons or property, (3) immediate action is required to prevent serious dislocation in the marketplace, and (4) delay in promulgation will cause an injurious inconsistency between an agency rule and a newly enacted statute or judicial decision.” Recommendation No. 83-2, Administrative Conference of the United States, *The “Good Cause” Exemption from APA Rulemaking Requirements*.¹⁸ Courts differ and vary in their analysis of “good cause,” and the specific facts and relevant circumstances will likely determine the outcome of judicial review.¹⁹ Here, the absence of specific statutory dictates underlying the Fiduciary Rule accords DOL greater discretion to take the time to deliberate over changes to the prior Administration’s policy choices.²⁰

¹⁷ An agency is not required to follow the notice and comment process when promulgating an interpretive rule. An interpretive rule is “issued by an agency to advise the public of the agency’s construction of the statutes and rules which it administers.” *Shalala v. Guernsey Memorial Hospital*, 514 U.S. 89, 99 (1995). Because interpretive rules “do not have the force and effect of law and are not accorded that weight in the adjudicatory process,” *Id.*, an agency is not required to follow the notice and comment process. As the Fiduciary Rule was certainly a legislative rule, the notice and comment exception for interpretive rules, see 5 U.S.C. §553(b)(A), is inapplicable.

¹⁸ To be sure, these exceptions are “narrowly construed.” *American Fed. of Gov’t Employees v. Block*, 655 F.2d 1153, 1156 (D.C. Cir. 1981) (quoting *New Jersey EPA v. EPA*, 626 F.2d 1038, 1045 (D.C. Cir. 1980). The exceptions may not “be arbitrarily utilized at the agency’s whim.” *Id.* (quoting S. Rep. No. 725, 79th Cong., 1st Sess. (1945)). The “exceptions should be invoked only in emergency situations when delay would do real harm[;] ... [b]ald assertions that the agency does not believe comments would be useful cannot create good cause to forgo notice and comment procedures.” *Action on Smoking & Health v. Civil Aeronautics Board*, 713 F.2d 795, 800 (D.C. 1983).

¹⁹ See generally, Congressional Research Service, “The Good Cause Exception to Notice and Comment Rulemaking: Judicial Review of Agency Action” (Jan. 29, 2016), <https://fas.org/sgp/crs/misc/R44356.pdf>; see also *Mid Continent Nail Corp. v. United States*, 846 F.3d 1364, 1381 (Fed. Cir. 2017) (rejecting “good cause” exemption to notice and comment because “mere pocketbook (or balance-sheet) harm to regulated entities is generally not sufficient to establish good cause”).

²⁰ See *Natural Resources Defense Council v. Abraham*, 355 F.3d 179 (2d Cir. 2004) (rejecting “good cause” delay where statutory dictates constrained agency’s ability to amend rule).

III. “Good Cause” Exemption to Notice and Comment Regarding Applicability Date

As noted above, following a notice and comment period, DOL published a final rule delaying the applicability date of the Fiduciary Rule until June 9, 2017 (“April 7 Delay Rule”).²¹

In promulgating the April 7 Delay Rule, DOL complied with the APA’s notice and comment procedures.²² As a result, DOL should ordinarily follow the same notice and comment procedures to further extend the applicability date of the current Fiduciary Rule. *See Perez v. Mortgage Bankers Ass’n.*, 135 S.Ct. 1199, 1206 (2015) (citing *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009) (the APA “make[s] no distinction . . . between initial agency action and subsequent agency action undoing or revising that action”).

Despite a need for additional notice and comment to extend the applicability date of the Rule under the APA, DOL could be exempted from the notice and comment procedures if it determines that “good cause” exists. If it qualifies for the “good cause” exemption, DOL could issue an interim final rule that delays the applicability date for 180 days, provided that DOL determines that further notice and comment are “impracticable, unnecessary, or contrary to the public interest.” 5 U.S.C. § 553(b)(B). Here, the need for yet additional comment on extending the applicability date would not be likely to provide significant additional input to the agency given DOL’s prior collection of comments on “further extension” and the comments received in response to the substantive review of the Rule in response to its March 2 NPRM.

The “good cause inquiry is inevitably fact- or context-dependent.” *Mid-Tex Elec. Co-op, Inc. v. FERC*, 822 F.2d 1123, 1132 (D.C. Cir. 1987). In determining whether an agency’s decision to issue an interim rule can be sustained under the “good cause” exception, a court will examine whether: “(1) congressional authorization for the authorization for the issuance of interim final rules; (2) the difficulty in promulgating final rules with notice and comment prior to the effective date of the statute; (3) the affected community’s need for regulatory guidance; and (4) the interim nature of the rule.” *Coalition for Parity, Inc. v. Sebelius*, 709 F. Supp. 2d 10, 20 (D.D.C. 2010) (citing *Nat’l Women, Infants & Children Grocers Assoc. v. Food & Nutrition Serv.*, 416 F. Supp. 2d 92, 105-108 (D.D.C. 2006)). Because the agency will be engaged in a time consuming process to reconsider the existing regulation, the market needs a longer term framework to avoid regulatory confusion, *see Mid-Tex Elec. Co-op, Inc.*, 822 F.2d at 1132-34. In light of the approaching June 9 applicability date, and the ongoing review of comments on the substance of the Rule, “good cause” exists to exempt notice and comment. Moreover, to the extent that the interim rule is tailored, the need for public comment is less. *Tenn. Gas Pipeline Co. v. FERC*, 969 F.2d 1141, 1144 (D.C. Cir. 1992). DOL could invoke the “good cause” exemption to issue an interim final rule without notice and comment.

Here, the potential harm to property and disruption to the marketplace is manifest. Accordingly, it would be the antithesis of “whim” for the DOL to conclude that it had “good cause” to forgo notice and comment regarding further delay of the Rule in order to allow the

²¹ 82 Fed. Reg. at 16,902.

²² 82 Fed. Reg. at 12,319.

agency proper time for the new Administration’s policy review. *Compare Action on Smoking & Health v. Civil Aeronautics Board*, 713 F.2d 795, 800 (D.C. Cir. 1983) (“exceptions should be invoked only in emergency situations when delay would do real harm[;] ... [b]ald assertions that the agency does not believe comments would be useful cannot create good cause to forgo notice and comment procedures”).

Moreover, the financial planning industry needs guidance of its compliance obligations in light of DOL’s review of the Fiduciary Rule. While an agency’s desire to provide immediate guidance does not by itself constitute “good cause” to avoid notice and comment procedures, it is one factor to justify invocation of the good cause exemption. *See Nat’l Women, Infants & Children Grocers Assoc.*, 416 F. Supp. 2d at 107 (recognizing a “compelling need” to have an interim rule in effect before the effective date of statutory changes to a federal grant program so states could have guidance from the agency); *see also Mid-Tex Elec. Co-op*, 822 F.2d at 1132-33 (citing concerns about “regulatory confusion in the absence of an interim rule”). By issuing an interim rule to delay the applicability delay without notice and comment, DOL would be able to provide prompt guidance to the industry about its obligations under the regulations prior to the current June 9 applicability date.

Here, the need for yet additional comment on extending the applicability date would not be likely to provide significant additional input to the agency given DOL’s prior collection of comments on “further extension” of the applicability date in response to its March 2 NPRM, together with the comments received in response to the substantive review of the Rule. To begin, the interim final rule would essentially preserve the status quo to allow DOL to conduct a deliberate and least disruptive review of the substance of the Fiduciary Rule. The interim final rule would provide DOL an orderly opportunity to conduct a thorough review of the many comments it is receiving in response to the March 2 NPRM.²³

It is worth noting that the additional extension period is necessary because DOL’s promulgation of the April 7 Delay Rule, and its provisional assessment of the important policy considerations underlying the Fiduciary Review and the corresponding costs of delay, occurred before the appointment of the new Administration’s Secretary of Labor or other key regulatory policymakers.²⁴ The President is entitled to review and consider changing the policy preferences of the prior Administration that are embedded in the Fiduciary Rule. *See Chevron, U.S.A., Inc.*,

²³ Indeed, the first Obama administration proposed to extend the effective and applicability dates of rules promulgated by the prior administration and relating to investment advice under ERISA and the Internal Revenue Code for 60 days to allow public comment on questions of law and policy raised by the rules. *Investment Advice-Participants and Beneficiaries*, 74 Fed. Reg. 6,007 (Feb. 4, 2009). After receiving comments, the Department adopted the proposed 60-day extension, 74 Fed. Reg. 11,847 (Mar. 20, 2009 delay), and thereafter extended the deadline two more times, 74 Fed. Reg. 23,951 (May 22, 2009 delay); 74 Fed. Reg. 59,092 (Nov. 17, 2009 delay), before ultimately withdrawing the rule, 74 Fed. Reg. 60,156 (Nov. 20, 2009).

²⁴ *See* Labor Department Mutiny, WSJ (April 12, 2017), <https://www.wsj.com/articles/labor-department-mutiny-1492038464> (noting that the DOL does not have an acting head appointed by President Trump); *see* President Donald J. Trump Announces Intent to Nominate Personnel to Key Administration Posts (Apr. 7, 2017), <https://www.whitehouse.gov/the-press-office/2017/04/07/president-donald-j-trump-announces-intent-nominate-personnel-key> (noting that the President announced his intent to nominate Neomi Rao to be the Administrator of the Office of Information and Regulatory Affairs).

467 U.S. at 865 (“[A]n agency to which Congress has delegated policy-making responsibilities may, within the limits of that delegation, properly rely upon the incumbent administration’s views of wise policy to inform its judgments.”). As a practical matter, the type of substantive policy review required to re-evaluate the Fiduciary Rule will entail the involvement of appointees at the Labor Department and Office of Information and Regulatory Affairs at OMB who have not yet been confirmed by the Senate. DOL could thus justify an additional extension to the applicability date without notice and comment to provide the Administration’s new head an opportunity to consider and review the complex policy considerations of the Fiduciary Rule.

As noted, DOL’s interim final rule must account for its changed view of the assessment of the costs of delay beyond a 60-day delay contained in the April 7 Delay Rule.²⁵ *See FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009) (an agency must “provide [a] reasoned explanation for its action [which] would ordinarily demand that it display awareness that it *is* changing position”). DOL’s interim final rule should therefore address the comments received in response to the March 2 NPRM addressing the substance of the Fiduciary Rule, and adequately explain the reasons for any change in the agency’s position regarding the costs and benefits of further delaying the Rule to allow time for adequate policy review by the new Administration.

As a result, DOL could invoke the “good cause” exemption to bypass the notice and comment process and issue an interim final rule to delay the applicability date of the Fiduciary Rule for 180 days. *See, e.g., Mid-Tex Elec. Co-Op, Inc.*, 822 F.2d at 1132 (noting that agency established good cause for omitting notice and comment procedures because the agency’s action was of a “temporally limited scope” while the agency proceeded its consideration without “dilatatory tactics”); *Riverbend Farms, Inc. v. Madigan*, 958 F.2d 1479, 1486 (9th Cir. 1992) (permitting the Secretary of Agriculture to invoke good cause to bypass the APA’s 30 day publication requirement because it would cause harm by forcing the agency to predict proper restrictions in advance of when a reasonable determination could be made); *Nader v. Sawhill*, 514 F.2d 1064, 1068 (Temp. Emerg. Ct. App. 1975) (permitting invocation of the good cause exception when notice of a price increase would worsen oil supply shortages); and *DeRieux v. Five Smiths, Inc.*, 499 F.2d 1321, 1332 (Temp. Emerg. Ct. App. 1975) (permitting the invocation of the good cause exception when notice “of a future price freeze would generate a ‘massive rush to raise prices’”).

In addition, DOL can base its argument that it may forgo any additional notice and comment process for delaying and proposing to withdraw the Rule, based on its evaluation of the substantive comments received in response to the March 2 NPRM. That NPRM requested comments from interested parties on the Fiduciary Rule and noticed that DOL was considering whether:

[T]o allow the final rule and PTEs to become applicable, *issue a further extension of the applicability date*, propose to withdraw the

²⁵ 82 Fed. Reg. at 16,906 (Apr. 7, 2017) (“a longer delay of the Rule and Impartial Conduct Standards cannot be justified based on the public record to date”); *Id.* (“[i]n the absence of the Impartial Conduct Standards, retirement investors are likely to continue incurring new losses from advisory conflicts,” and that “[l]osses arising from a delay of longer than 60 days would quickly overshadow any additional compliance cost savings”).

rule, or propose amendments to the rule and/or the PTEs. In addition to any other comments, the Department specifically requests comments on each of these possible outcomes.²⁶

As a result, DOL may permissibly determine, without an additional notice and comment period that “withdraw[al] and “further extension of the applicability date” is warranted provided DOL recognizes it is changing course from the April 7 Delay Rule, provides a reasoned explanation for the change, and addresses any comments received.²⁷ In pursuing this course, as previously discussed, DOL could rely on the changed policy positions of the new Administration and the substantial comments received to justify a further extension.

IV. DOL Authority to Revise/Rescind the Fiduciary Rule

In addition to the applicability date, the March 2 NPRM invited comments on “the questions raised in the Presidential Memorandum and generally on questions of law and policy concerning the final rule and [prohibited transaction exemptions including the Best Interest Contract Exemption and amended prohibited transaction exemptions].”²⁸ The NPRM further stated that “[u]pon completion of its examination, the Department may decide to allow the final rule and PTEs to become applicable, issue a further extension of the applicability date, propose to withdraw the rule, or propose amendments to the rule and/or the PTEs.”²⁹ DOL “specifically request[ed] comments on each of these possible outcomes.”³⁰

The NPRM thus envisions that there will be a further rulemaking regarding withdrawal or revisions if the DOL determines that the Fiduciary Rule negatively impacts individuals. *See* 82 Fed. Reg. 12,320 (noting the Presidential Memorandum’s directive that if “the final rule is inconsistent with the priority of the Administration ... *then* the Department shall publish for notice and comment a proposed rule rescinding or revising the final rule”). As a result, if DOL determines that it wishes to withdraw and permanently rescind the Fiduciary Rule, DOL should issue an NPRM proposing to withdraw the Rule, but also seeking comments on whether to allow the Rule to become effective, permanent rescission of the Rule, or possible revision. If DOL proposes to permanently rescind or maintain the Fiduciary Rule, DOL could proceed to a final rule. If DOL proposes to revise the Fiduciary Rule, however, the revised future NPRM will have to set forth the full text of the proposed rule, and provide an ample opportunity for public comment on the specific proposals.³¹

²⁶ 82 Fed. Reg. at 12,325 (emphasis added).

²⁷ *See FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009) (ruling that an agency “need not demonstrate to a court’s satisfaction that the reasons for the new policy are better than the reasons for the old one; it suffices that the new policy is permissible under the statute, that there are good reasons for it, and that the agency believes it to be better, which the conscious change of course adequately indicates”).

²⁸ 82 Fed. Reg. at 12,319.

²⁹ *Id.* at 12,325.

³⁰ *Id.*

³¹ *See Assoc. of Private Sector Colleges and Univs. v. Duncan*, 681 F.3d 427, 442 (D.C. Cir. 2012) (noting that the APA requires that all interested parties have an opportunity to comment on new regulations); *Mid Continent Nail Corp. v. United States*, 846 F.3d 1364, 1374 (Fed. Cir. 2017) (*quoting CSX Transp. Inc. v Surface Transp. Bd.*, 584

In issuing a final rule revising, rescinding or maintaining the Fiduciary Rule, DOL would have to “provide [a] reasoned explanation for its action [which] would ordinarily demand that it display awareness that it *is* changing position.” *Fox Television Stations, Inc.*, 556 U.S. at 515 (emphasis in original); *id.* at 535 (Kennedy, J., concurring in part and concurring in the judgment) (underscoring that “an agency’s decision to change course may be arbitrary and capricious if the agency sets a new course that reverses an earlier determination but does not provide a reasoned explanation”). DOL’s main obligation will be to demonstrate that any new or revised rule is the “product of reasoned decisionmaking.” *Motor Vehicle Mfrs. Ass’n of U.S., Inc. v. State Farm Mut. Auto Ins. Co.*, 463 U.S. 29, 52 (1983). This requires that the agency examine the relevant data and articulate a satisfactory explanation for its action, including a rational connection between the facts found and the choice made. DOL will be required to ensure that it evaluates all data and explains, in a thorough manner, its policy decisions and justifications for any new action.

DOL is free to consider new policy reasons to justify a new or revised rule. *See National Ass’n of Homebuilders v. EPA*, 682 F.3d 1032, 1037-1038 (D.C. Cir. 2012) (holding that “it was hardly arbitrary or capricious for EPA to issue an amended rule it reasonably believed would be more reliable, more effective, and safer than the original rule”). A change in administration is manifestly among the policy reasons courts have found to justify revising a rule. *See Nat’l Cable & Telecommunications Ass’n v. Brand X Internet Servs.*, 545 U.S. 967, 981 (2005) (holding that “[a]n initial agency interpretation is not constantly carved in stone” and that the agency “must consider ... the wisdom of its policy” in response to “a change in administrations”); *Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 865 (1984) (“[A]n agency to which Congress has delegated policy-making responsibilities may, within the limits of that delegation, properly rely upon the incumbent administration’s views of wise policy to inform its judgments.”); *Motor Vehicle Mfrs. Ass’n of U.S., Inc.*, 463 U.S. at 59 (Rehnquist, C.J., concurring in part and dissenting in part) (noting that “[a] change in administration brought about by the people casting their votes is a perfectly reasonable basis for an executive agency’s reappraisal of the costs and benefits of its programs and regulations”); *National Ass’n of Homebuilders v. EPA*, 682 F.3d at 1043 (noting that the change in the administration can justify a new regulation if the rule remains in the bounds established by Congress). The new Administration is thus free to reevaluate the policy decisions made by the previous administration; however, in changing the rule, DOL must acknowledge the change and explain any new justification.

Finally, DOL is also free to reevaluate the facts justifying the Fiduciary Rule and is not required to identify and rely on new facts. *National Ass’n of Homebuilders*, 682 F.3d. at 1038 (“EPA did not rely on new facts, but rather on a reevaluation of which policy would be better in light of the facts.”). DOL is not required to “demonstrate ... that the reasons for the new policy are *better* than the reasons for the old one; it suffices that the new policy is permissible under the statute, that there are good reasons for it, and that the agency *believes* it to be better.” *Fox*

F.3d 1076, 1081 (D.C. Cir. 2009) (noting that the NPRM must ask for “comments on a particular issue or otherwise ma[ke] clear that the agency [is] contemplating a particular change”).

Television Stations, Inc., 556 U.S. at 515 (emphases in the original). Once DOL provides a “reasoned explanation for its action,” *Id.*, and the action is within the bounds of Congressional authorization, DOL has met its burden.

In revising, permanently rescinding, or maintaining the Fiduciary Rule, DOL will have to address assertions in its April 7 Delay Rule with respect to delay.³² In the April 7 Delay Rule, DOL asserted that “it would be inappropriate to broadly delay application of the fiduciary definition ... in disregard of its previous findings of ongoing injury to retirement investors.” Similarly, the Department asserted that “fundamental fiduciary norms help[] ensure that investment recommendations are not driven by adviser conflicts, but by the best interest of the retirement investor.” This language, which was promulgated during the current Administration but prior to the confirmation of the new Secretary of Labor and other senior policymakers,³³ asserts that there are some benefits to the Fiduciary Rule. DOL is not bound by this language, however. *See Chevron*, 467 U.S. at 866 (deferring to an Agency construction when the legal challenge “really centers on the wisdom of the agency’s policy”). Presumably the existence or not of the asserted benefits would be subject to policy review when the new Secretary of Labor and other Presidential appointees of the new Administration take office. Nevertheless, DOL must explain any departure from this language in its final Rule.

V. Conclusion

DOL may forgo notice and comment and extend the applicability date of the Fiduciary Rule by interim final rule because it can demonstrate good cause or because the March 2 NPRM envisioned further delay as a potential agency action, as discussed above. DOL will have to justify its invocation of the good cause exemption to § 553 notice and comment process, acknowledge its changed position with respect to the cost-benefit analysis, and address the comments received. Provided DOL demonstrates “good cause,” DOL could issue this interim final rule extending the applicability date for 180 days effective immediately provided the agency reviews any comments on whether the 180-day delay is appropriate and revise if necessary. The interim final rule should also advert to a forthcoming notice of proposed rulemaking proposing to withdraw the Rule, and seeking comments on whether the Rule should be permanently rescinded, revised or maintained. This course of action will provide an orderly plan to avoid imposing considerable and unnecessary regulatory compliance costs that may not ultimately be required if DOL determines to permanently rescind the Rule. This approach will also allow appropriate substantive deliberation and the avoidance of undue disruption and dislocation in the relevant marketplace of investors and regulated entities. If DOL determines to

³² 82 Fed. Reg. at 16,902.

³³ While all new regulations were to be reviewed by the department or agency head prior to publication in the Federal Register, *See Memorandum for the Heads of Executive Departments and Agencies; Regulatory Freeze Pending Review* (Jan. 20, 2017), 82 Fed. Reg. 8,346 (Jan. 24, 2017), <https://www.whitehouse.gov/the-press-office/2017/01/20/memorandum-heads-executive-departments-and-agencies>, DOL does not appear to have a presidentially-appointed official in place. *See Labor Department Mutiny*, WSJ (April 12, 2017), <https://www.wsj.com/articles/labor-department-mutiny-1492038464>. Therefore, in promulgating any final rule, DOL’s explanation of these statements as potentially inconsistent with the Administration’s policy position should be entitled to deference. *See Christensen v. Harris County*, 529 U.S. 576, 587 (2000).

revise the Rule, any future proposed revision of the Fiduciary Rule would of course need to be published for comment in a new NPRM.

Appendix II



The Fiduciary Rule

Sailing Through the Fiduciary Fog

November 2016

Contents

Executive Summary..... 3

Background 5

Adjusting to new expectations 9

 Steady implementation of fiduciary rule 9

 Compliance hurdles loom large 10

Changing tides: Land, ho!..... 12

 Sailing away from commission..... 12

 Mass market clients thrown overboard — but automated advice reels them in..... 14

 Advisors must adapt or walk the plank..... 17

 Product offering castaways..... 20

The future of advice..... 22

About CoreData Research..... 24

Executive Summary

The Department of Labor's (DOL) fiduciary rule is making waves as one of the most impactful pieces of regulation in the advice industry for decades. The rule requires all advisors on retirement accounts to act as fiduciaries, meaning they have to carry out decisions in the best interests of clients.

Advisors are wary about adopting the Best Interest Contract Exemption (BICE), which permits conflicted compensation. While advisors can still receive commission, many are unsure whether to sign-up or change their business model. Over four in ten (41%) advisors who currently get commission will look to receive commission in retirement accounts through BICE.

However, commission-based compensation may be on its way out in the long term. A majority (58%) of financial advisors who currently receive commission say they will move away from it by 2020 in order to get ahead of potential future regulation. Furthermore, 74% of advisors think the fiduciary rule will in the future be expanded to non-retirement accounts.

The fiduciary rule could result in mass market investors being left out in the cold, creating the prospect of an advice gap. Seven in ten (71%) financial advisors will disengage with at least some mass-market investors because of the DOL's rule. These advisors estimate they will disengage with an average of 25% of their mass market clients.

Meanwhile, the cost of advice is expected to increase and be passed on to investors. Nearly four in ten (39%) advisors believe the cost of personal financial advice will become too expensive for most investors. While the rule aims to benefit investors, 45% of advisors believe investors would rather have cheaper, non-fiduciary advice than more expensive fiduciary advice.

Automated advice could be the only option for low-balance clients. An overwhelming 94% of respondents agree that smaller clients 'orphaned' by advisors are likely to turn to automated advice.

Advisors and their firms are looking to hire new staff, work longer hours and adjust the time they spend on different tasks. Over a third (36%) of advisors plan to hire additional staff due to the DOL's fiduciary rule and 86% intend to work more hours per week. Advisors also expect to spend more time on compliance by 2018.

Elsewhere, advisors are focusing less on investment management and more on meeting and managing clients. Advisors currently spend an average of 42% of their time meeting and

managing existing clients but expect this to rise to 45% by 2018. Selecting and managing investments currently takes up 25% of their time but they think this will drop to 21% by 2018.

In terms of product offerings, we could see a fresh focus on low-cost options. More than six in ten (62%) advisors believe the rule will lead to an increase in ETF recommendations in their retirement accounts. Furthermore, 60% believe non-traded REITs and 57% think variable annuity product offerings will decrease due to the DOL rule.

The rule underscores a trend toward more regulation across the industry. Nearly all advisors (95%) think the industry is moving toward transparency and full disclosure in the long term rather than trust-based advisory models.

The rule will help carve out new advice models. Nearly nine in ten (87%) advisors are focusing more on their value propositions in a bid to differentiate themselves in light of the new fiduciary rule.

Background

On April 6, 2016, the Department of Labor introduced a long-awaited ruling which requires advisors to put the interests of their clients above their own, adhering to a fiduciary standard of advice.

The Best Interest Contract Exemption (BICE) allows advisors to receive commission and other sales fees while still complying with the fiduciary standard. All of which means commission stays, but how easy this will be for advisors to implement is uncertain.

The rigidity of the BICE guidelines has eased significantly since conception. Originally, the exemption limited the scope of permissible assets to recommend (non-traded REITs were not permitted for example) and required extensive disclosure on fees and costs. The implementation period of the rule has also changed, with the full compliance deadline extended one year until January 1, 2018.

These developments should ease some of the concerns over the regulatory costs of the rule but will not fully eliminate them. The financial industry has warned the cost of the rule will make advice more expensive and that the financial burden will fall upon consumers — as was the case when similar regulation was introduced in other countries.

Opponents of the rule argue smaller clients will be faced with unaffordable fees, thereby limiting the access that middle-class investors have to advice. Previous CoreData analysis revealed that about seven in ten advisors in the UK said the Retail Distribution Review (RDR) had made it more challenging to work with low balance clients. To combat this, a third said they would consider adding an execution-only service for low balance clients.

Retail Distribution Review



RDR in the UK



As a result of RDR, one-fifth (19%) of advisors reported a decrease in the number of clients they advise

Four in ten (44%) said RDR had an impact on the investment products they advise on



One in five (19%) reported hiring new people as a result of RDR



RDR in South Africa



Three years after implementation, one in four (26%) reported they will decrease the number of clients they advise

Four in ten advisors (39%) said RDR will have an impact on the investment products they advise on



One in five (20%) reported hiring new people as a result of RDR

Indeed, similar regulation in the UK and South Africa has steered middle-class investors away from advice. Previous CoreData studies show about one in five advisors in the UK and one in four in South

Africa reported a decrease in the number of clients they advise. Regulation has also impacted investment products. About four in ten advisors in the UK and South Africa said regulation had influenced the investment products they advise on.

Advisory firms in the US are expected to hire new staff to help implement the rule. This would mirror the example of advisors in the UK and South Africa who reported taking on new staff (and the associated costs) to help comply with regulation. About one in five in the UK and South Africa cited regulation as reason for hiring new people.

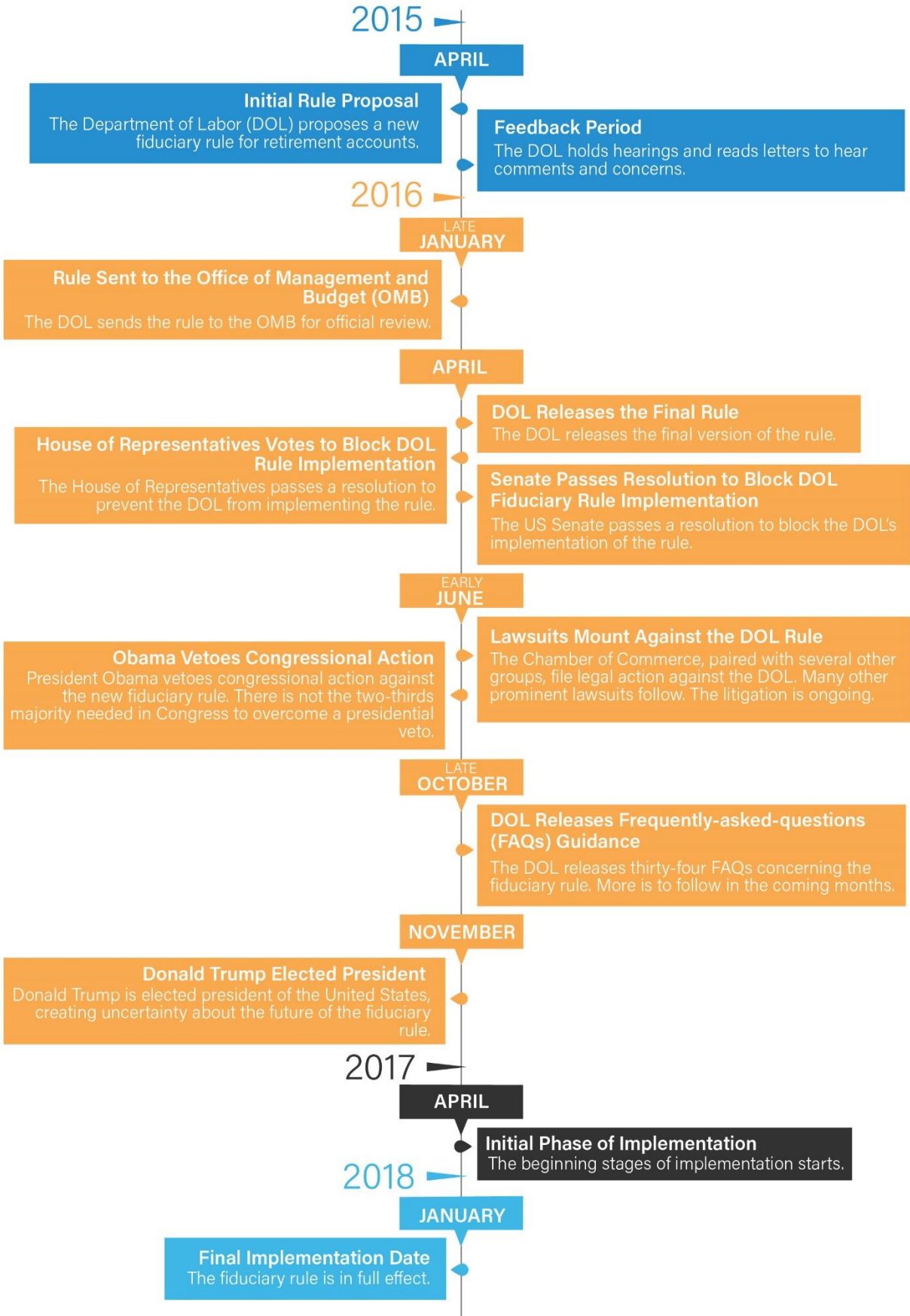
Under the new rules, the BICE heightens brokers' liability risk. This impacts the cost-benefit analysis of the commission model. If advisors want to continue earning commission, they must sign a legally binding contract with clients detailing their fiduciary responsibilities, revealing any potential conflicts of interest and stating firm policies to mitigate conflicts of interest. While the contract aims to hold advisors accountable, the cost of implementation is high.

If advisors are to demonstrate the advice they give is in the best interest of clients, they will have to develop a solid understanding of client needs in order to justify their recommendations. Many think this will result in advisors spending more time meeting clients. This certainly holds true for the UK, where four in ten said they met with clients more following regulatory change.

Even though commission-based advice is still allowed under the new US rule, many firms with revenues heavily derived from commission will look at redressing the balance between upfront fees and commission. Although the DOL rule has evolved into a more diluted version of the original proposal, advisors should nevertheless reconsider their compensation policies for the long-term in light of increased regulation and scrutiny of the industry.

How President-elect Donald Trump will approach the fiduciary rule remains uncertain. Before the election, the rule was set to progress forward.

FIDUCIARY RULE TIMELINE



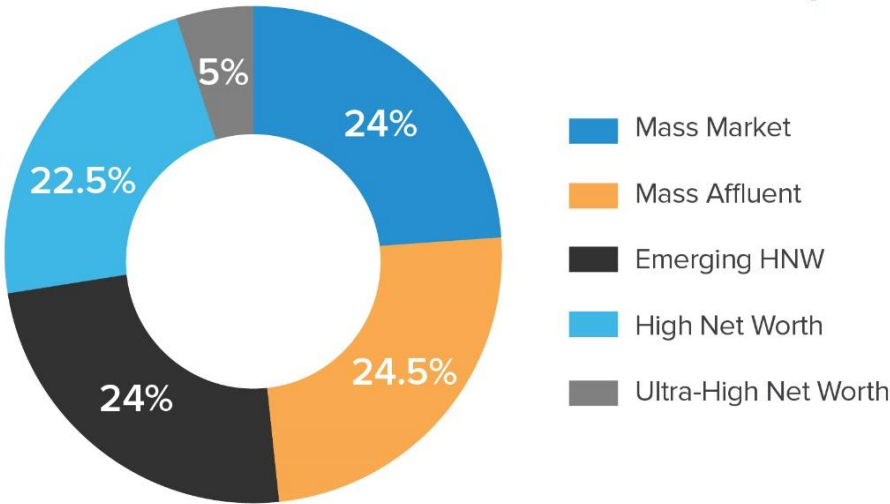


Introduction

What do advisors see when they imagine their careers in the future? How will they receive their compensation? What will regulation on the industry look like? In October 2016, CoreData went out to 552 US financial advisors who give advice on retirement accounts. In April of 2016, new regulation concerning permissible compensation for retirement accounts, known as the fiduciary rule, was laid out, with full adoption set for 2018. This report looks at the impact of the rule on advisors and how it will shape the future of advising.

ADVISOR SNAPSHOT

Client Wealth Segment



Mass-market investors, the most likely wealth segment to be affected by the rule, make up almost a fourth (24%) of the average advisor's clientele.

How Advisor Income is Split

Commissions make up a sizeable portion (29%) of the average advisor's income today.



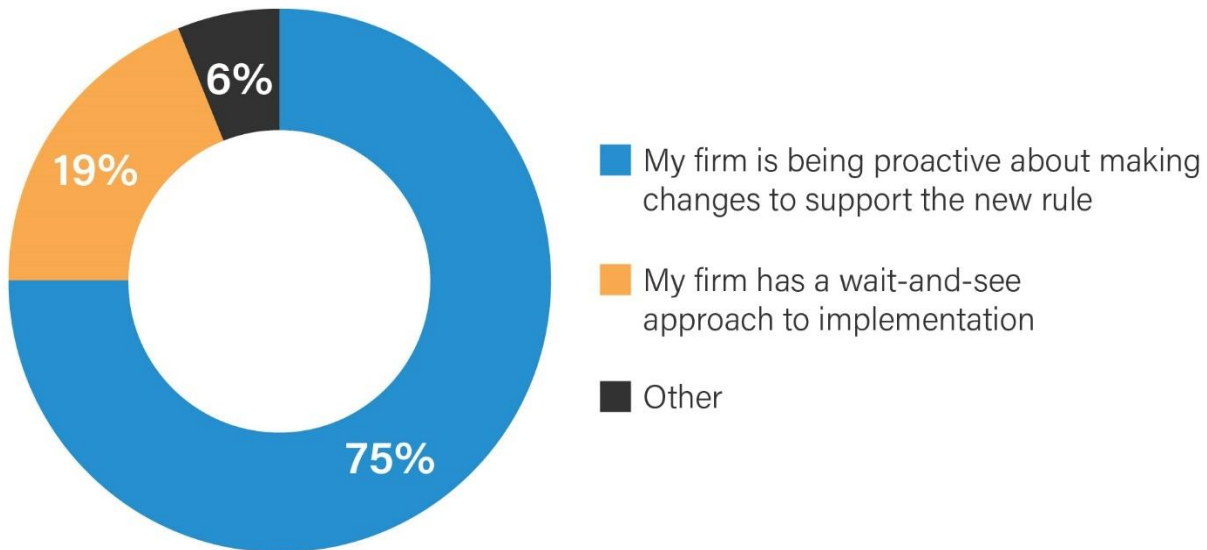
Types of Fees	Percentage of advisors who charge this fee	Average charge
An upfront advice fee	21%	\$1,725
A per hour advice fee	9%	\$226
An annual asset-based advice fee	95%	1.1%

Adjusting to new expectations

Steady implementation of fiduciary rule

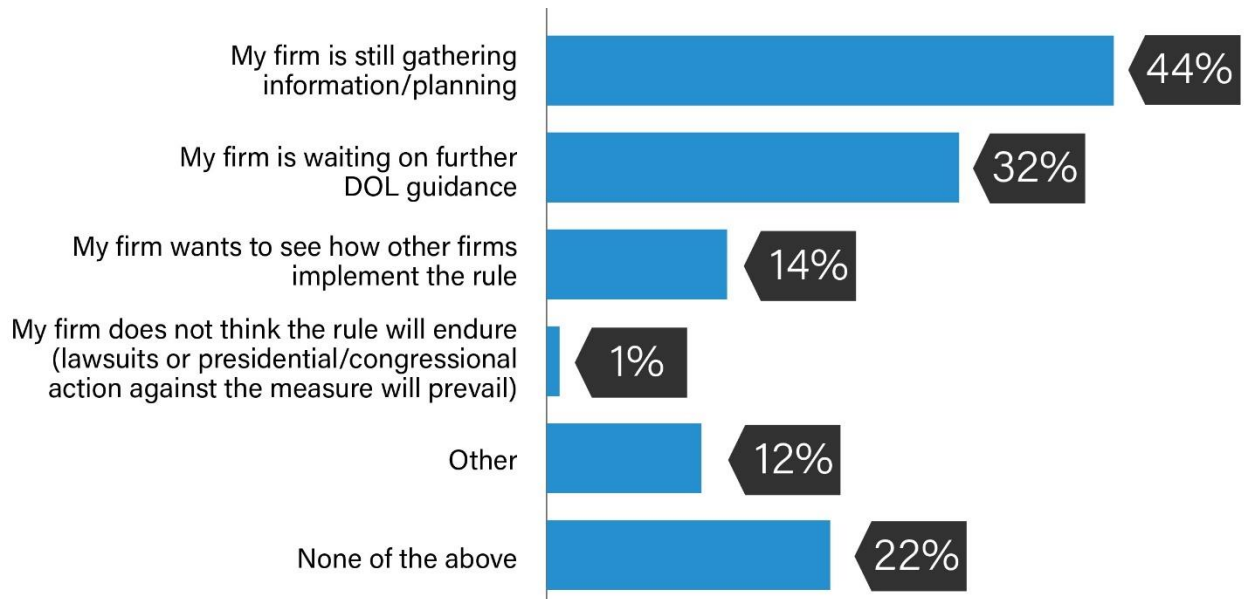
Advisors are busy preparing for the DOL’s fiduciary rule. The rule entails a sizeable shakeup of the status quo and will require firms to react, adapt and implement. Three in four (75%) advisors believe their firm is being proactive and making the necessary changes to support the new rule. Only one in five firms (19%) has adopted a “wait-and-see” approach to implementation.

How Advisor Firms Are Preparing for Fiduciary Rule



Yet despite the proactive approach, just under half (44%) of advisor firms are still gathering information/planning and one in three (32%) are waiting on further DOL guidance. With the rule taking effect in April 2017 and full adoption not expected until 2018, advisors do have a grace period. Firms are still analyzing the implications of the rule amid a host of uncertainties. Furthermore, many advisors are still waiting for guidance from the DOL, suggesting a sizable proportion remain unclear about the specifics of the rule. The DOL, however, released an FAQ document in October and promised more guidance to come.

How Advisor Firms Are Progressing for Implementation



Copycat tendencies also play into the wait-and-see mentality as 14% of advisors want to see how other firms implement the rule. How their competitors and peers react to the rule can ultimately affect the way in which they choose to proceed.

While there is some caution around its implementation, the overwhelming majority see the DOL rule as being the law of the land. Nearly all advisors (99%) believe the rule will survive lawsuits or presidential/congressional action against it. But sentiment can change quickly and it is unclear whether Donald Trump will back the rule or roll it back. The future looks somewhat cloudier than before the presidential election, when this research was conducted.

Compliance hurdles loom large

The rule presents many compliance and operational hurdles for advisors to overcome. As expected, advisors are preparing for an increase in paperwork. A majority (57%) believe increased paperwork stemming from reporting and disclosure requirements will be one of the top three challenges of the fiduciary rule. Compliance training is a concern for more than a quarter (28%) of advisors.

Advisors are also in a heightened state of readiness for a potential rise in lawsuits related to the fiduciary rule. Nearly two in 10 advisors (18%) believe preparing for potential litigation will be one of the biggest challenges they must overcome. And 12% think the need to invest in appropriate technologies to aid compliance and implementation constitutes a major challenge.

Biggest Challenges of Fiduciary rule



Other pressing challenges facing advisors include limitations on IRA rollovers (48%), changes to compensation structure (35%), a shift away from certain products (32%), differentiating advice between retirement and non-retirement accounts (20%) and increased competition among fiduciary advisors (10%). As advisors look to juggle a host of challenges, they may look to manage compliance-related issues as a first step before addressing other ramifications of the rule.

Changing tides: Land, ho!

Sailing away from commission

Of the concerns surrounding the fiduciary rule, the shift from commission to a fee-based compensation structure looms the largest. A third (35%) of advisors believe changes to compensation structure are one of the biggest challenges posed by the DOL's fiduciary rule. The objective of preventing advisors from recommending certain products to clients simply because they carry higher commission lies at the very heart of the rule. While commissions are still permissible, the cost of implementing the rule has nudged some advisors toward a fee-based compensation model.

Advisors are currently presented with three options under the new rule: Keep receiving commission on retirement accounts through the BICE, switch to level-fee advising or stop advising on retirement accounts altogether.

While advisors can still receive commission-based compensation, many are unsure of whether to do so under the BICE. Four in ten (41%) advisors currently receiving commission will collect commission in retirement accounts through the BICE, while 29.5% will opt against and a surprising 29.5% are still undecided. While advisors claim to be taking a proactive approach to implementation, almost a third of them are unsure about one of the most crucial aspects of the rule.

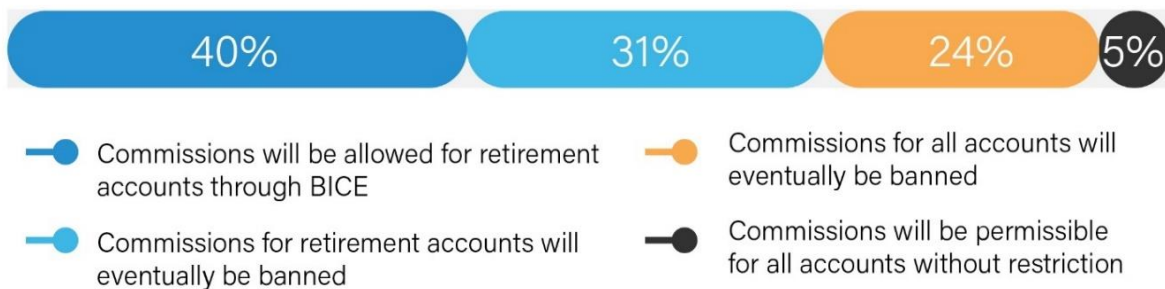


A majority (58%) of financial advisors say they will move away from commission by 2020 in order to get ahead of potential future regulation, while 28% are unsure. But switching to level-fee advising will not enable advisors to completely sidestep compliance requirements. All advisors must still adhere to limited disclosure obligations. However, becoming level-fee fiduciaries will ease compliance and legal burdens and, more importantly, safeguard against potential RDR-style future regulation. Many advisors realize the fiduciary rule will lower the profitability potential of the commission model and some are deciding whether it will be worth it for their business in the long-term.

Advisors do not see the scrutiny surrounding compensation structures fading from view any time soon. A huge majority (93%) acknowledge the industry is moving toward more tightly regulated than self-regulating markets. In the long-term, 55% of advisors believe commission on retirement accounts will eventually be banned and 24% of this group believe commission on all accounts will be banned.

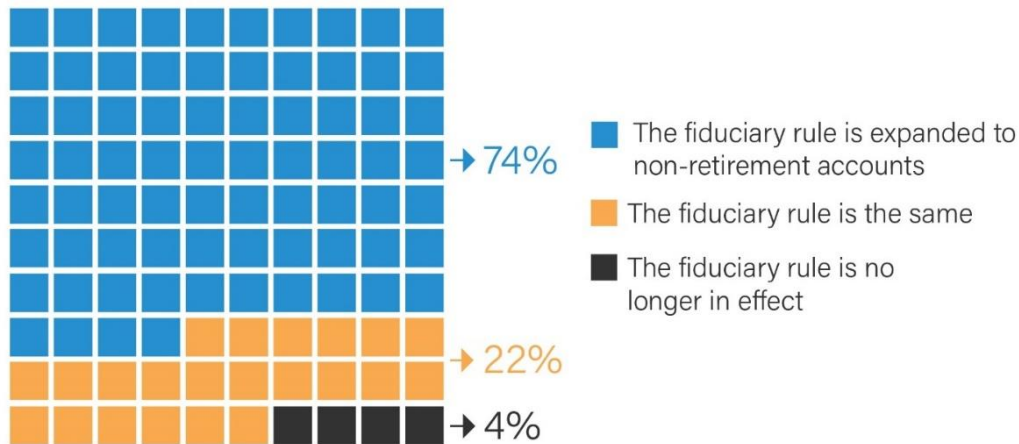
At least one thing is clear in the eyes of advisors: the days of unfettered commission appear to be over. Only 5% of advisors believe commission will be permissible for all accounts without restriction in the future.

How Regulation Will Impact Commission in the Long Term



Indeed, advisors believe the fiduciary rule will overreach and stray into the rest of the advisory arena. Three in four advisors (74%) think the rule will be expanded to non-retirement accounts. Given such sentiment, a wider shift away from commission seems likely.

Fiduciary Rule Prospects

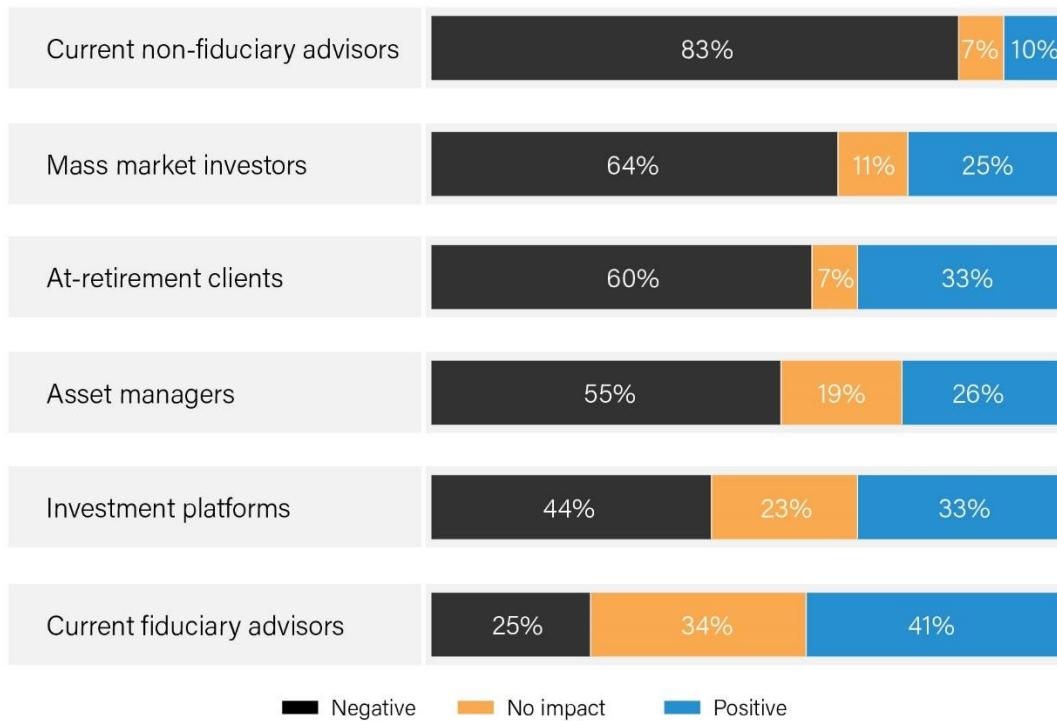


A third option — to stop advising on retirement accounts — is an unpopular choice. An overwhelming majority (88%) will not stop advising on retirement accounts altogether because of the new fiduciary rule. A further 10% remain unsure and 1% will abandon 401(k)s and IRAs. Given the regulation may eventually expand in scope to become account-wide, shifting away from retirement accounts may prove unfruitful. In the meantime, those switching to level-fee fiduciaries on retirement advice but not on other accounts will have to ensure they walk that line carefully. But abandoning retirement accounts is a drastic step many would see as an option of last resort.

Mass market clients thrown overboard — but automated advice reels them in...

One of the biggest concerns about the fiduciary rule is that investors will not receive the advice they need because it will become too costly. Two-thirds (64%) of advisors view the impact of the fiduciary rule on mass market investors as largely negative. Furthermore, 60% believe the fiduciary rule will have a negative impact on at-retirement clients — the group that arguably needs advice the most.

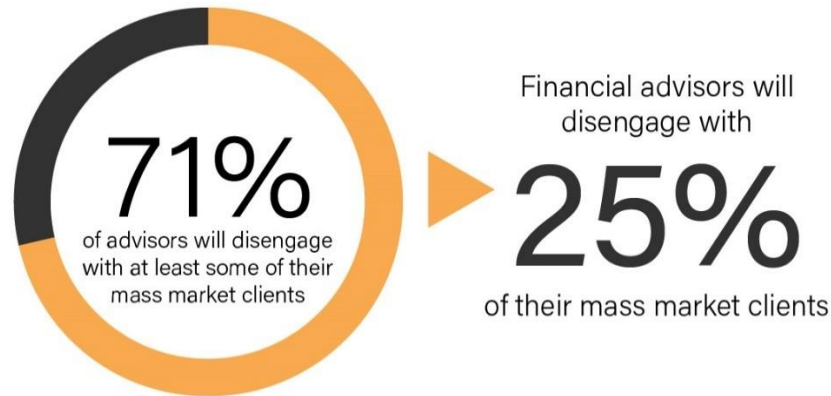
Impact of the Fiduciary Rule



The hardest hit group is expected to be current non-fiduciary advisors, with 83% saying the impact will be negative. If non-fiduciary advisors struggle with rising costs emanating from the rule, such costs could, at least partially, be passed down to clients. Low-balance clients would likely struggle the most when it comes to adjusting to rising costs.

Seven out of ten (71%) financial advisors will look to disengage from at least some mass-market investors due to the fiduciary rule. These advisors estimate, on average, they will disengage with approximately a quarter (25%) of their mass market clients.

Disengaging with Mass-market Investors



However, all is not lost for low-balance clients. While 39% of advisors believe the cost of personal financial advice will become too expensive for most investors, automated advice is poised to pick-up the slack left behind by traditional financial advisors.

With higher barriers to entry for new financial advisors and higher costs associated with their services, automated advice provides an important safety valve for investors left out in the cold.

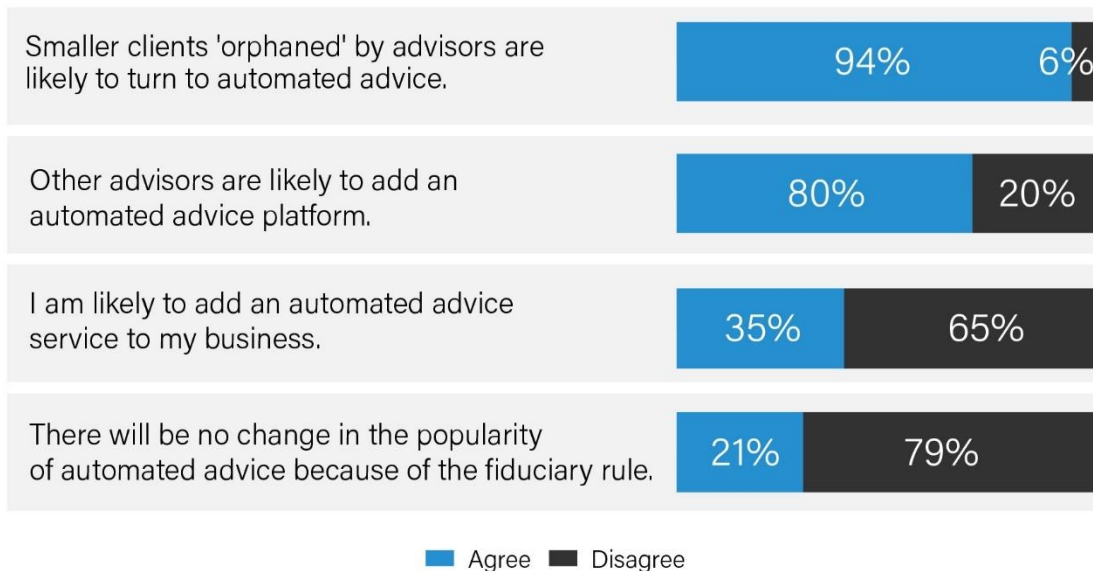
Fiduciary Rule Raising the Bar for both Advisors and Investors



The fiduciary rule was not intended to push investors into the arms of automated financial advice models — yet that appears to be a likely outcome.

A huge majority (94%) of advisors believe smaller clients ‘orphaned’ by advisors are likely to turn to automated advice as a result of the DOL rule. Advisors seem to have accepted the inevitability of the rise of automated advice and are now grappling with how they will coexist with each other. Automated advice is already on the rise but the fiduciary rule could exacerbate the trend.

Future of Automated Advice



A third (35%) of advisors will likely add an automated advice service to their business because of the fiduciary rule and 80% of respondents believe other advisors are likely to add an automated advice platform. The belief that the fiduciary rule will not impact automated advice has failed to gain any real traction — only a fifth (21%) believe there will be no change in the popularity of automated advice due to the rule.

And if the rule is going to make advice costlier then advisors will need to consider ways of making personalized advice more affordable for clients. Almost half (45%) of advisors believe investors would rather have cheaper, non-fiduciary advice than more expensive fiduciary advice. While this suggests widespread misgivings over the rule, advisors will need to adapt to the new environment.

Advisors must adapt or walk the plank

In the post-fiduciary rule world, advisors will have to demonstrate their value over other fiduciary advisors more than ever. An overwhelming 87% of advisors are focusing on their value proposition more to differentiate themselves in light of the new fiduciary rule. One in ten (10%) advisors think one of the biggest challenges of the fiduciary rule will be increased competition among advisors. Better communication, an ability to establish rapport and trust and more open access to services are all ways advisors can compete and demonstrate their value to clients.

Advisor-Investor Relationship



87%

I am focusing on my value proposition more to differentiate myself in light of the new DOL fiduciary rule



72%

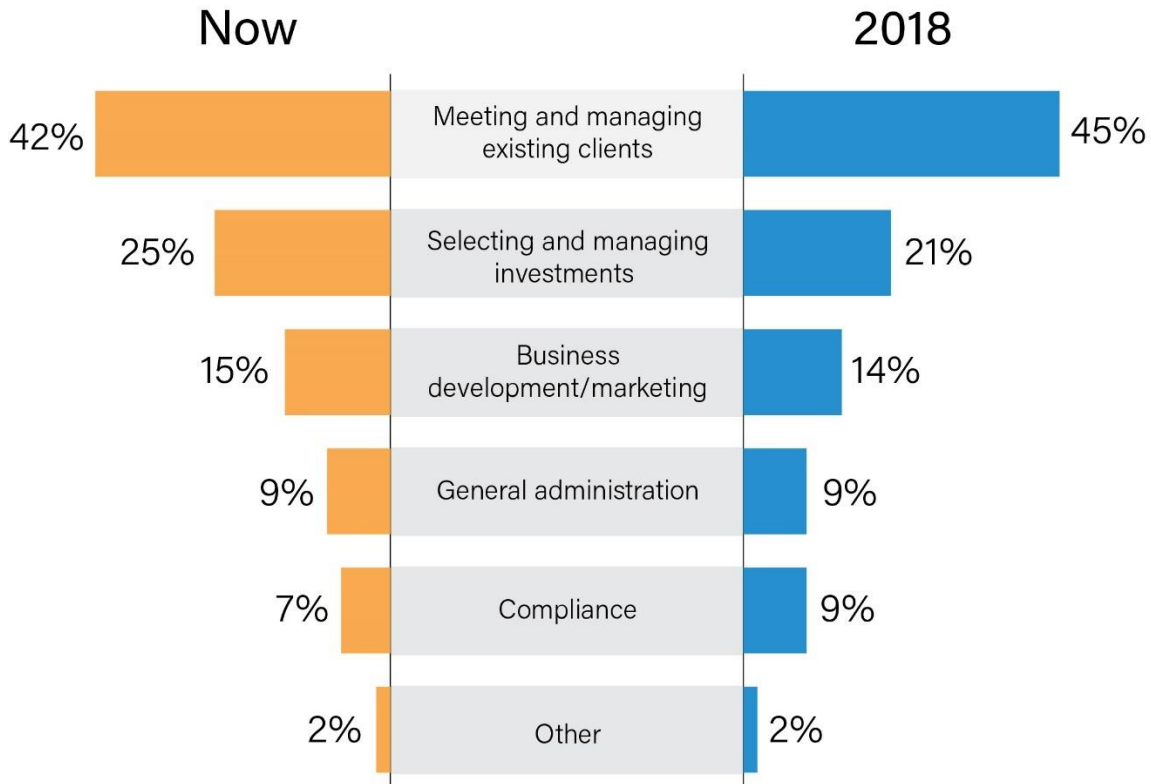
I have already started talking to my clients about the new rule

There are undoubtedly some positives for investors stemming from the new rule. The fiduciary rule has helped create a dialogue between advisor and investor, with 72% of advisors saying they have already started talking to their clients about the rule. This is an encouraging sign given that many firms (44%) are still in the gathering information/planning stage. Even if advisors do not understand the full implications of the rule, they are still creating a dialogue with clients that will hopefully keep communication channels open throughout the implementation process.

Indeed, the fiduciary rule appears to be encouraging greater relationship building. Advisors are focusing less on investment management and more on meeting and managing clients. Outsourcing to investment specialists is in vogue — a shift that began even before the DOL rule proposal. In the new low return world, creating dynamic client relationships could hold the key to client retention.

Currently advisors spend an average of 42% of their time meeting and managing existing clients and by 2018 expect this to rise to 45%. Conversely, managing and selecting investments takes up 25% of their time now and they expect this to drop to 21% by 2018.

Advisor Time Allocation



Connecting with clients and managing their needs and expectations will be at the forefront of advisor minds going forward.

Increased regulation raises the prospect of firms hiring more staff to bolster resources and better serve clients. Nearly one in four (23%) advisors believe their business is likely to hire new employees for their compliance and legal teams. Complying with the fiduciary rule will demand more organizational muscle and coordination. Over a third (36%) of advisors plan to hire additional staff as a result of the rule and 86% plan to work more hours per week.

36% of advisory firms will hire new staff

% of advisors who will hire the following staff:

Compliance/Legal staff	23%
Administrative staff	19%
Fiduciary advisory staff	14%
IT staff	6%
Business development staff	6%
Other	2%

86% of advisors will work more hours

On average, advisors will work an additional

4.6 HOURS
per week

On average, advisors will work an additional 4.6 hours per week as more responsibility is placed on their shoulders.

The fiduciary rule will also alter how much time advisors spend on compliance. Currently, advisors spend an average of 7% of their time on compliance but they expect this to increase to 9% by 2018. A picture is emerging of advisors having to adjust their time management as they work more hours and hire more staff to better meet the needs of the fiduciary rule.

Product offering castaways

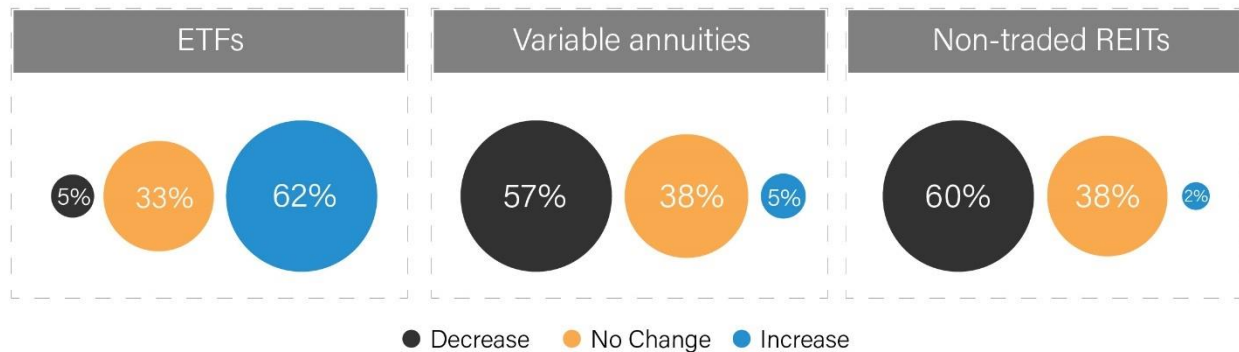
The passing of the fiduciary rule will have a demonstrable effect on investment selection. Advisors will be discouraged from recommending certain products where a strong case can be made that the selections are not in the best interest of clients.

As a result, the fiduciary rule could accelerate the trend toward passive investment strategies. One of the major goals of the fiduciary rule is that of minimizing instances where advisors recommend higher cost products with higher commissions when lower cost investments more appropriate for the investor are available. This is at the very core of the fiduciary rule: steering advisors away from recommending investments that are more profitable for them but might not be in the best interests of clients.

Six in ten (62%) advisors say they will increase ETF recommendations in their retirement accounts. Greater adoption of automated advice models will also help fuel a shift toward passive investments.

As ETFs are set to rise in popularity, other products could see a dent in demand. For example, 60% of advisors say they will decrease allocations to non-traded REITs and 57% say they will limit offering variable annuities in retirement accounts due to the fiduciary rule.

Product Offerings Affected



Issues surrounding non-traded REITs were at the center of the original proposal for the fiduciary rule. REITs were not included in the initial proposal specifying certain asset classes that could be included in retirement accounts, but the DOL subsequently ended up scrapping the list of asset classes altogether. However, it will be harder to argue that including non-traded REITs in retirement accounts will be in the best interests of clients if they continue to attract high commissions.

Advisors will also have to prove that variable annuities are in the best interests of clients. Advisors will have to delve into the specifics of both the product and their client to assess suitability. Variable annuities have been criticized for their high charges and complex details. Fee-based annuity contracts are expected to become more popular because they avoid the conflicts of interest that commission-based products are susceptible to. But advisors will still need to examine the specifics of the contract to ensure they adequately address client needs.

Advisors recognize that moving away from certain products will be part of the adjustment process to the new normal established by the fiduciary rule. About a third (32%) believe shifting away from certain products, such as annuities and non-traded REITs, is one of the biggest challenges posed by the fiduciary rule.

Limitations on IRA rollovers, another hotly-contested aspect of the fiduciary rule throughout its creation, is another challenge for close to half (48%) of advisors. Advisors must assess the fee structure of the IRA rollover comparative to that of a 401(k) plan. Often, 401(k) plan fees are lower than IRA rollovers so advisors will need to justify why an IRA rollover best suits a particular investor.

As new regulation fuels changes in allocation trends, some advisors appear to be concerned about their ability to demonstrate value in their product recommendations. Managing the fiduciary rule's potentially negative effects and drawing on its positives will be the key challenge facing advisors in 2017.

The future of advice

The fiduciary rule changes the rules of the game. The financial advice model as we know it is ending and advisors must get on board or risk getting left behind.

Part of the headache over the rule is the sense of uncertainty surrounding it. It has been modified from the original proposal, praised and criticized by advisory firms, hotly debated by members of Congress and a new presidential administration now leaves more questions than answers. In October, just 1% of advisors said lawsuits or presidential/congressional action is likely to overturn the rule. While this number is likely to have now shot up, the rule is still set for implementation and advisors are preparing for it accordingly. Scrapping the rule would undoubtedly cause great inconvenience and potential harm to some of those advisory firms that have already spent time and money on implementation.

But despite the uncertainty surrounding the rule, advisors are in firm agreement on where the industry is heading. Nearly all advisors see the financial advice industry moving toward a service-based model (99%) with transparency and full disclosure (95%). On paper, this will prove beneficial to clients.

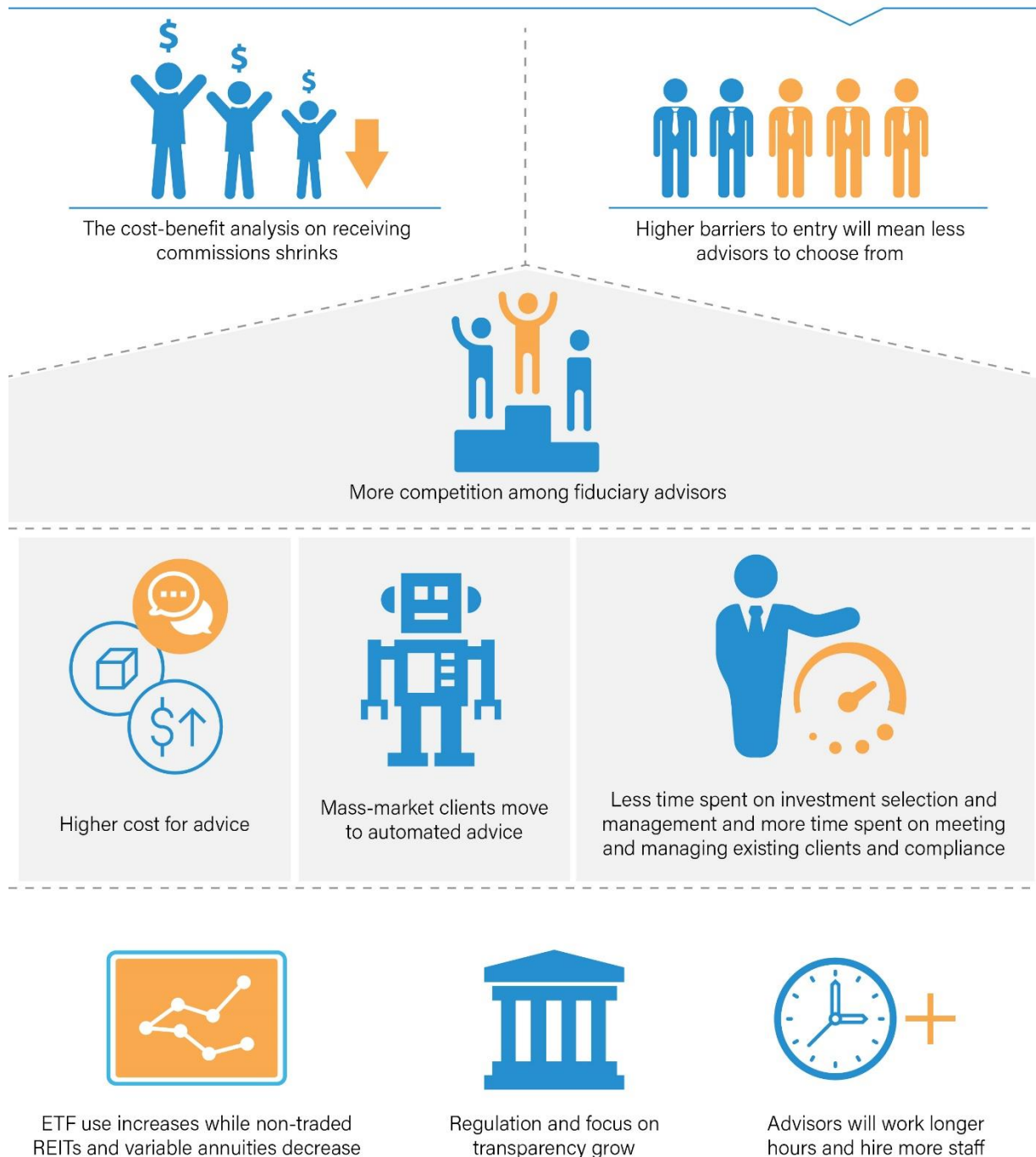
Direction of the Industry in the Long-term



But the rule could bring unintended and unwanted consequences. Replacing commission with a fee-based revenue model could create an advice gap for mass market clients. However, automated advice could help fill this gap. A significant majority of advisors think the industry will move toward automated advice (70%) in the future.

Advisors also think online tools (61%) will become more popular than in-person client catch-ups, creating an opportunity for advisors to use technology to expand their geographical footprint and reach out to new clients. However, this will potentially create further competition in the online space.

The Future of Advice



The ramifications of the fiduciary rule are far-reaching and the advice industry is in for quite a shakeup. The challenge facing advisors will be that of coping with the burden of the fiduciary rule in a way that ultimately benefits their clients.

About CoreData Research



CoreData Research UK is the London-based arm of a broader global specialist financial services research and strategy consultancy.

CoreData Research understands the boundaries of research are limitless and with a thirst for new research capabilities and driven by client demand; the group has expanded over the past few years into the Americas, Africa, Asia and Europe.

The London division is part of the CoreData Group and has operations in Australia, the United Kingdom, the United States of America, Malta, Mexico, Singapore, South Africa and the Philippines.

The group's expansion means CoreData Research has the capabilities and expertise to conduct syndicated and bespoke research projects on six different continents, while still maintaining the high level of technical insight and professionalism our repeat clients demand.

With a primary focus on financial services CoreData Research provides clients with both bespoke and syndicated research services through a variety of data collection strategies and methodologies, along with consulting and research database hosting and outsourcing services.

CoreData Research provides both business-to-business and business-to-consumer research, while the group's offering includes market intelligence, guidance on strategic positioning, methods for developing new business, advice on operational marketing and other consulting services.

CoreData Research prides itself in identifying market trends at the earliest opportunity and formulating insightful quantifiable research that clients can use to help them stay ahead of the market and better meet the day-to-day challenges facing their businesses.

Our focus is on bringing deep market knowledge to research and strategy development. The group's research is not just about information and data but at providing insight so clients can develop strategies that work.

The team is a complimentary blend of experienced financial services, research, marketing and media professionals, who together combine their years of industry experience with primary research to bring perspective to existing market conditions and evolving trends.

CoreData Research has developed a number of syndicated benchmark proprietary indexes across a broad range of business areas within the financial services industry.

- Experts in financial services research
- Deep understanding of industry issues and business trends
- In-house proprietary industry benchmark data
- Industry leading research methodologies
- Rolling benchmarks

The team understands the demand and service aspects of the financial services market.

The group conducts regular research in banking, mortgages, retail saving, pensions, asset management and the financial advisory sector.

It is continuously in the market through a mixture of constant researching, polling and mystery shopping and provides in-depth research at low cost and rapid execution.

The group builds a picture of a client's market from hard data which allows them to make efficient decisions which will have the biggest impact for the least spend.

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Appendix III



A.T. Kearney study: The \$20 billion impact of the new fiduciary rule on the U.S. wealth management industry

Perspective for Discussion

October 2016

Industry Perspective: Executive Summary (1 of 2)

- On April 6, 2016, the Department of Labor released the final version of its regulation, expanding fiduciary responsibility to advisors to 401K plans and IRAs—requiring all professionals to recommend what is in the “best interests” of their clients
- The new rule, expected to go into effect in April 2017, will result in several important changes, including requiring advisors to adhere to a “best-interest standard,” new compliance protocols, an increased level of scrutiny on fees and advisor compensation, and accelerated product shifts to fee-based and robo-advisory.
- Our studies reveal a **\$20 billion revenue impact for the industry** through 2020, along with significant asset shifts across players and formats within the wealth management value chain.
- Industry players will be impacted at all levels. To remain competitive and viable, all must aggressively address these changes
 1. **Wirehouses** will accelerate their ongoing transition to fee-based advisory, while capitalizing on their ability to continue to sell high-fee proprietary products following the most recent rule revision
(expected impact by 2020: assets: **-\$300 billion, -5 percent**; revenues: **-\$4 billion, -8 percent**)
 2. **Broker/dealers** will see a significant sales impact as high-commission products (such as annuities) lose favor. Additionally, consolidation will likely occur as smaller independent broker/dealers struggle to comply to the new rule
(expected impact by 2020: assets: **-\$250 billion, -6 percent**; revenues: **-\$3 billion, -11 percent**)
 3. **Independent broker/dealers** will face the largest disruption, as the rule will strain the resources of smaller players. This will drive industry consolidation and the potential outflow of advisors to other distribution formats, like dual RIAs
(expected impact by 2020: assets: **-\$350 billion, -11 percent**; revenues: **-\$4 billion, -22 percent**)
 4. **Dual RIAs** will see their business model shift as “hybrids” focus in the near term on building their RIA businesses, and along with others in the industry they will accelerate the transition to more fee-based advisory
(expected impact by 2020: assets: **+\$100 billion, +5 percent**; revenues: **-\$0.5 billion, -3 percent**)
 5. **RIAs**, who already operate under similar fiduciary standards, will stand to gain significant market share as most are already equipped to comply with the rule
(expected impact by 2020: assets: **+\$250 billion, +10 percent**; revenues: **+\$1.5 billion, +5 percent**)

Industry Perspective: Executive Summary (2 of 2)

6. **Robo-advisory** adoption will accelerate as accounts flow away from broker/dealers and undersized accounts are dropped as fee-based advisory changes the economics for managed advice.
(expected impact by 2020: assets: +\$250 billion, +15 percent, revenues: +\$1 billion, +15 percent)
 7. **Self-directed** will benefit from these trends, as accounts that don't flow into robo-advisory will go directly into mutual funds and exchange-trade funds. Products will also likely be streamlined as high-fee, low-performance funds lose favor.
(expected impact by 2020: assets: +\$150 billion, +4 percent, revenues: +\$1 billion, +4 percent)
 8. **Retirement plan administrators**, most of whom play other roles in the value chain, will need to reconsider their business model as their significant revenue source (12b-1 fees for product placements) will come under pressure.
(expected impact by 2020: assets: +\$200 billion, +3 percent, revenues: -\$1 billion, -5 percent)
 9. **Manufacturers** will experience significant asset flow and will be incentivized to streamline product offerings, lower fees, and improve performance.
(expected impact on mutual funds by 2020: assets: -\$1 trillion, -6 percent), revenues: -\$14 billion, -11 percent)
(expected impact on exchange-traded funds by 2020; assets: +\$1 trillion, 45 percent, revenues: +\$1 billion, 30 percent)
- In all cases, industry players can take targeted actions to both minimize disruption and position themselves for longer-term growth.
 - Two distinct set of measures in response to the rule stand out as a way industry players can differentiate and stand out for the future
 1. **Implement key compliance measures** to ensure the company and business model are ready for the rule to take effect with minimal disruption and risks.
 2. **Reposition strategy for the future** to help seize the rule as an opportunity to enhance strategies, challenge business models, and accelerate many of the ongoing efforts already taking place across the industry.

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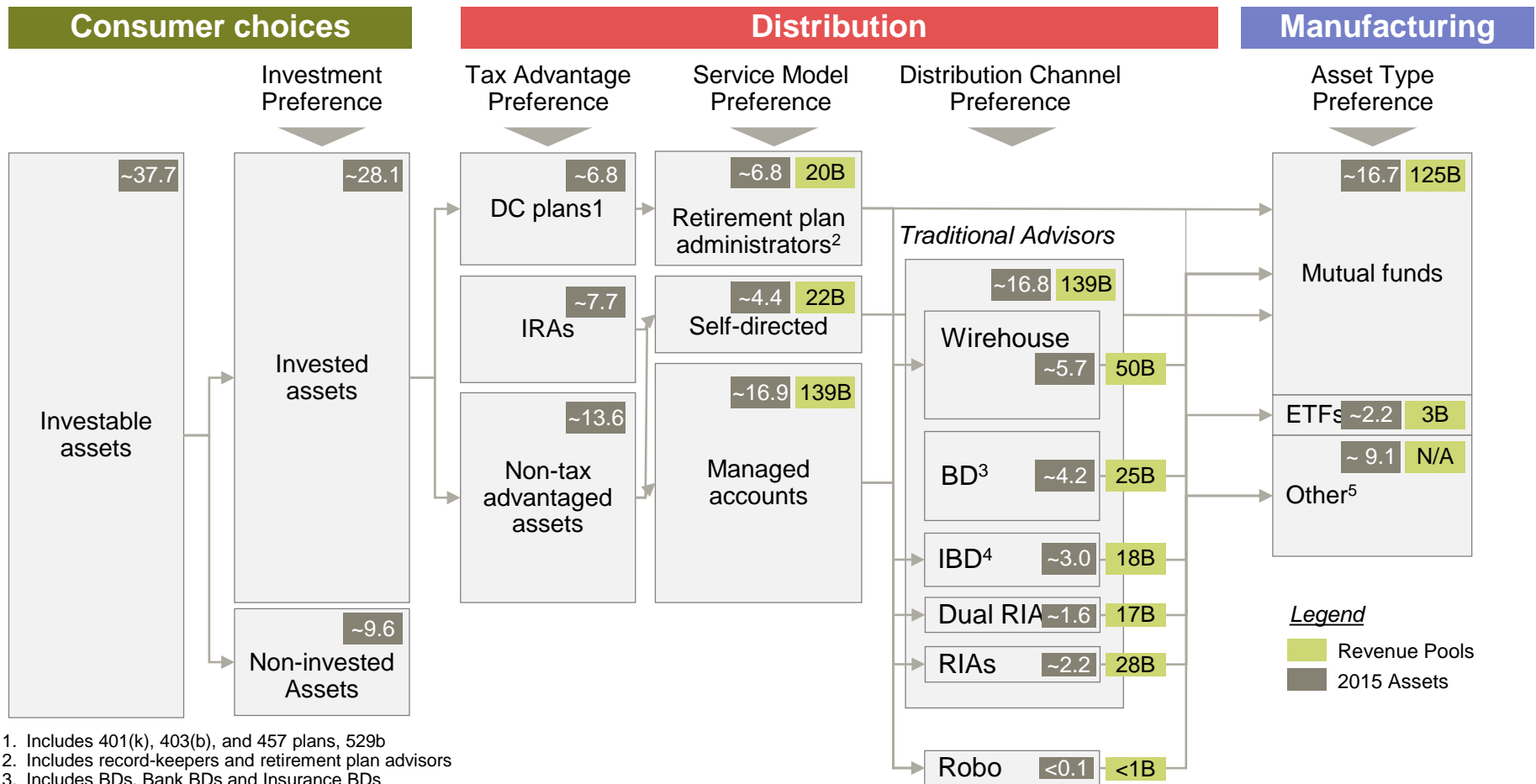
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Contents

- **Overview: Department of Labor fiduciary rule update and impact on the industry**
- Perspectives on how industry players should respond & reposition for the future
- Immediate next steps and potential A.T. Kearney support options

Today, the US wealth management value chain is highly complex and interdependent

Wealth management value chain and revenue pools, 2015



1. Includes 401(k), 403(b), and 457 plans, 529b
 2. Includes record-keepers and retirement plan advisors
 3. Includes BDs, Bank BDs and Insurance BDs
 4. Includes regional BDs
 5. Includes individual equity, fixed income, and alternatives

Note: DC is deferred compensation. IBD is independent brokers/dealers. RIA is registered investment advisor. ETF is exchange-traded fund.
 Source: ICI Factbook 2014, Federal Reserve 2015, Cerulli Associates Advisor metrics (2013); A.T. Kearney analysis

On April 6th of this year, the final version of the DOL Fiduciary Rule was released and stands to make a significant impact on the industry

DOL Fiduciary Rule – A Quick Overview

The Quick Facts...

- Issued by US Department of Labor (DOL)
- Final version released April 6th, 2016 (after two previous iterations)
- Latest version incorporate revisions based on stakeholder feedback between 2010-2015
- Most provisions take effect April 2017, with full implementation by January 2018

What Changes (The Impact)...

A “Best Interest” Standard

- *All professionals offering advice on 401(k) plan assets and individual retirement accounts (IRAs) need to recommend what is in the best interests of clients*

New Compliance Challenges

- *Brokers and advisors now need to operate in a new stricter regulatory environment – this will require sizable investments in technology and compliance measures*

Increased Focus on Compensation

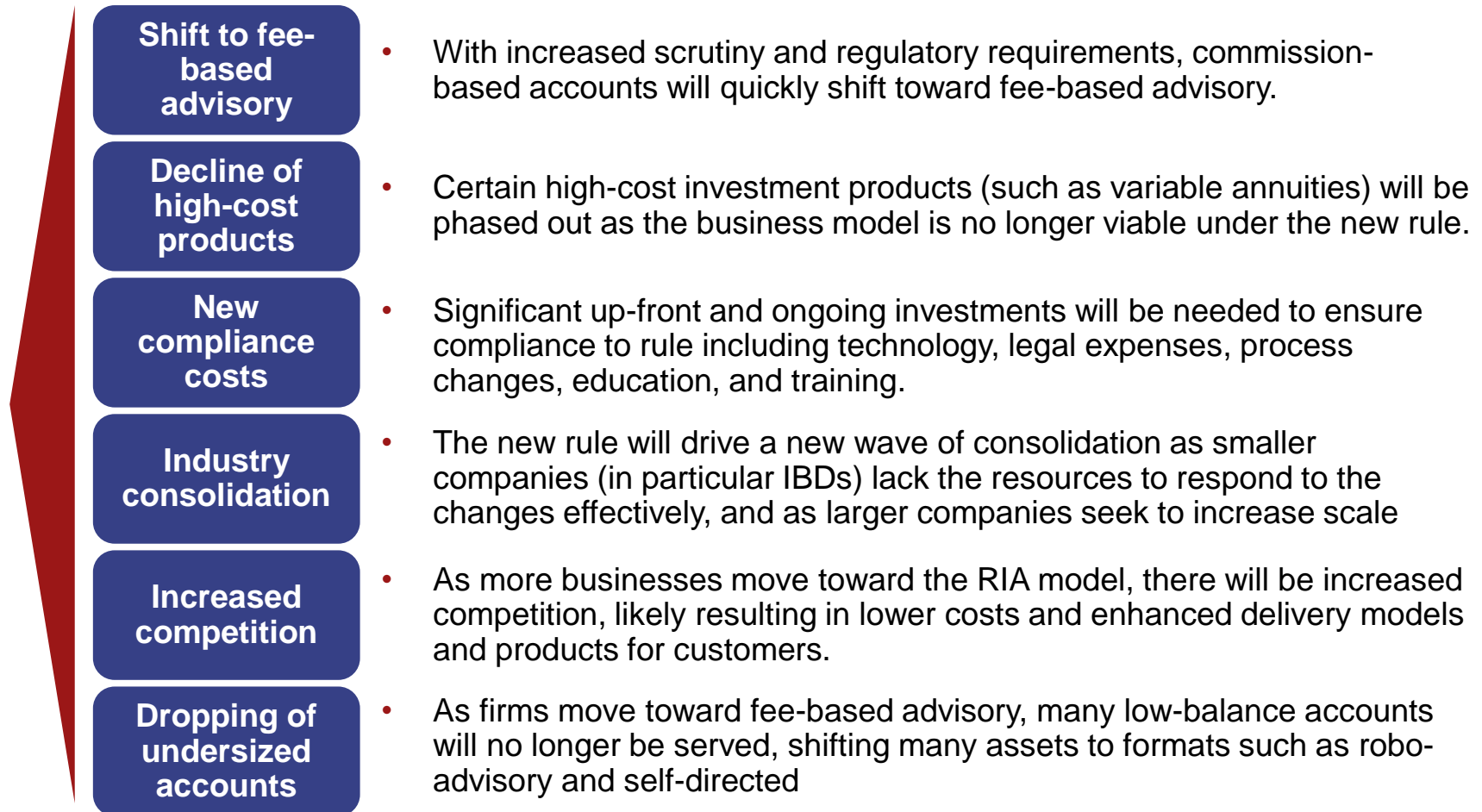
- *Rule will enforce a new level of disclosure and transparency to clients – accelerating the industry towards fee-based advisory*

Accelerated Changes to Business Models

- *Brokers and advisors will need to adjust product offerings and pricing as well as underlying business models (e.g. advice models toward RIAs, compensation structures)*

The rule will usher in several key shifts that industry players must understand to position themselves effectively for the future

Significant Shifts from the DOL Fiduciary Rule



Despite ongoing lobbyist attempts to repeal the rule, we believe the rule is here to stay—and more similar regulations are to come

DOL Rule – Here to Stay... (Observations)

- 1. Long time coming:** The latest DOL Rule comes at the heels of years of discussion and debate over the topic, and the latest rule already offers many key concessions.
- 2. Strong bipartisan support:** The rule has received strong support from President Obama as well as politicians from both sides of the aisle.
- 3. Positive public reaction:** The idea of “best interest” is favorable to the public, and this rule and similar ones will only gain traction with investors.
- 4. Other regulations already in the works:** The SEC and FINRA have already started drafting additional fiduciary standards that will expand regulation beyond retirement accounts.

As a result, it is important that the industry view the rule as an opportunity to enhance its long-term business strategy

The rule's impact will differ across the sector, as different players will have to react differently

Impact on along Wealth Mgmt. Value Chain – A Summary View

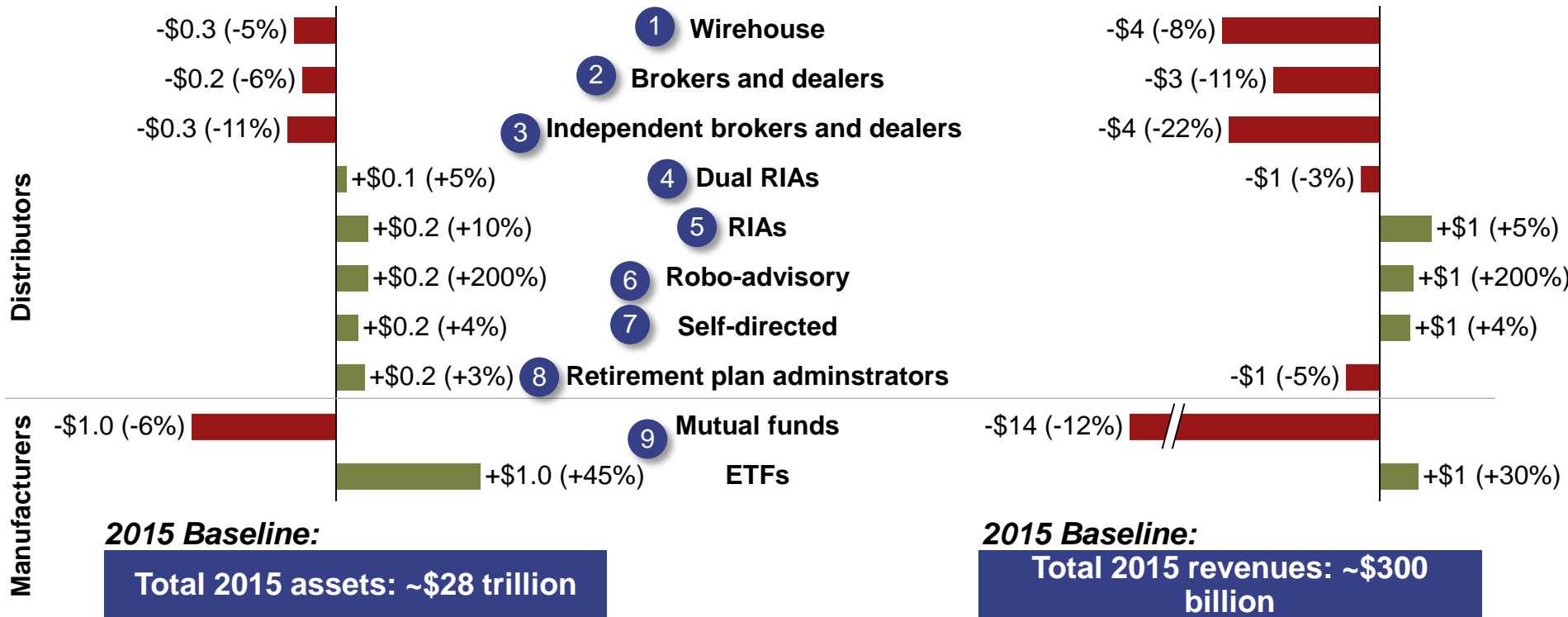
	Key players	2015 assets	Examples	Impact
Distribution	1 Wirehouses	~\$6 trillion	<ul style="list-style-type: none"> Merrill Lynch Morgan Stanley Wells Fargo UBS 	<p>"Measured loss"</p> <ul style="list-style-type: none"> Up-front investments to manage new compliance Accelerated transition to fee-based advisory Opportunity to continue to market proprietary products
	2 Brokers/dealers	~\$4 trillion	<ul style="list-style-type: none"> Bank BDs Insurance BDs Regional BDs 	<p>"Slowing sales"</p> <ul style="list-style-type: none"> Slowing sales of high-commission products (such as annuities) Push toward fee-based advisory Wave of BD consolidation or divestitures
	3 Independent brokers/dealers	~\$3 trillion	<ul style="list-style-type: none"> Raymond James Ameriprise Small and mid-size IBDs 	<p>"Significant disruption"</p> <ul style="list-style-type: none"> Increased regulation, straining smaller IBDs Potential wave of IBD consolidation for scale Incentives to drop undersized retirement accounts
	4 Dual RIAs	~\$2 trillion	<ul style="list-style-type: none"> Dually registered advisors Hybrid RIAs 	<p>"Business model shift"</p> <ul style="list-style-type: none"> Migration toward RIA business Measured exit of commissioned advisory (to fees) Increased risk control to identify conflicts of interest
	5 RIAs	~\$2 trillion	<ul style="list-style-type: none"> Independent RIAs 	<p>"Relative win"</p> <ul style="list-style-type: none"> Already operating at "best-interest" standards Minimal disruption to business Inflow of assets from BD and IBDs
	6 Robo-advisors	<\$100 billion	<ul style="list-style-type: none"> Vanguard Betterment Wealthfront 	<p>"Accelerated growth"</p> <ul style="list-style-type: none"> Inflow of assets from BD and IBDs, particularly undersized accounts Accelerated industry adoption
	7 Self-directed	~\$4 trillion	<ul style="list-style-type: none"> Online platforms <ul style="list-style-type: none"> Schwab TD Ameritrade 	<p>"Beneficiary"</p> <ul style="list-style-type: none"> Potential asset inflow from BD and IBDs (for example, undersized accounts)
	8 Retirement plan distributors	~\$7 trillion	<ul style="list-style-type: none"> T. Rowe Price Fidelity 	<p>"Marginal loss"</p> <ul style="list-style-type: none"> Revenue disruption as 12b-1 fees will be under pressure Benefits from a slowdown in IRA rollovers from 401(k) plans
	9 Manufacturers	~\$20 trillion	<ul style="list-style-type: none"> Vanguard BlackRock 	<p>"Revenue disruption"</p> <ul style="list-style-type: none"> Decline in expense ratios and accelerated flow from mutual funds to ETFs, due to increased cost and fee scrutiny

By 2020, the DOL's new fiduciary rule will result in a \$2 trillion asset shift and roughly \$20 billion in lost revenue

What this really means for the Industry (by the Numbers)...

~\$2 trillion asset shift

~\$20 billion in cumulative lost revenues



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In response to the rule – the industry is making targeted investments to ensure compliance by April 17th, 2017

Non-Exhaustive View

Critical Compliance Measures

Measure	Key Activities
<p>Establish deep understanding of the rule</p>	<ul style="list-style-type: none"> • Establish legal and investment team to review and understand rule and implications • Consult (as required) external experts, especially for fee benchmarks and litigation exposure • Understand Best Interest Contract Exemption (BICE) rule and which products require exemptions
<p>Enhance compliance and governance processes</p>	<ul style="list-style-type: none"> • Implement enhanced due diligence processes for selecting and monitoring products and service partners • Increase internal controls around commissions and fees, particularly for rollover accounts (especially RIAs, robo-advisors) • Establish formal mechanisms to monitor compliance in adherence to Department of Labor standards (such as, changes to investment committee review, outsourced partnership for compliance monitoring)
<p>Invest in technology solutions and upgrades</p>	<ul style="list-style-type: none"> • Leverage technology solutions (such as SS&C Advent) to support compliance • Integrate new policies and procedures as workflows into portfolio management, performance reporting, and document management systems • Implement enhanced analytics and reporting capabilities to streamline disclosures and proactively identify compliance risks
<p>Revise disclosures and investor information</p>	<ul style="list-style-type: none"> • Determine additional disclosures required and execute communication to investors (including all sales incentives, compensation, conflicts, fees, and expenses relating to advice provided) • Modify product descriptions and investor information material
<p>Train and educate advisors</p>	<ul style="list-style-type: none"> • Create training and education programs to field advisors for rapid deployment • Arm support and call center agents with information required to field both advisor and customer inquiries

In addition, industry players will need to rethink certain efforts and accelerate others to “win” in this new ecosystem

“Positioning for the Future” – Key Levers in Response to DOL Fiduciary Rule

“Rethink and adjust”

Key actions

Optimize product and service strategy

- Rethink or phase out commission-based and high-fee products, establish strategy to deploy BICE, and build new product pipeline based on Rule

Revise people and talent strategy

- Revise strategies to accommodate shift to fee-based advisory, including: advisor training, compensation structure (away from commissions), and recruiting and retention of top advisors

Explore M&A and partnerships

- Explore mergers and acquisitions as an option to increase scale and resources to comply with the rule and succeed in an increasingly cost-conscious sector

“Accelerate and magnify”

Key actions

Enhance customer engagement

- Find new ways to enhance customer value (such as new capabilities like robo) to seize market share as the rule forces consolidation and competition

Invest in enabling processes and technologies

- Invest in and broaden technology capabilities beyond compliance, including building digital capabilities and implementing customer big data and analytics

Launch targeted marketing efforts

- Deploy targeted marketing campaigns aimed at retaining and gaining market share as assets and customers flow away from traditional channels toward RIAs and robo-advisory

1 Wirehouses: Despite beneficial revisions in the final rule, wirehouses will still need to revise their business model

Projected impact by 2020

		Assets	Revenues
i	Decline in commissions and 12B-1 income from retirement accounts	-	~\$1 billion (2%)
ii	Brokers shift to fee-based models (RIA, dual RIA)	~\$100 billion (2%)	~\$1 billion (2%)
iii	Shift of low-balance retirement accounts	~\$150 billion (2%)	~\$1.5 billion (2%)
iv	Competition in fee-based models	-	~\$0.5 billion (1%)
vi	Slowdown in IRA rollovers	~\$50 billion (1%)	~\$0.5 billion (1%)
Total impact		~\$300 billion (5%)	~\$4 billion (8%)

Positioning for the future: key measures for wirehouses

Optimize product and service strategy:

- Assess commission-based IRA accounts and define strategies to convert to fee-based accounts
- Establish clear BICE guidelines and determine strategy to leverage exemption on existing products
- Identify target proprietary product portfolio to be used in retirement accounts

Revise people and talent strategy:

- Focus on converting brokers/dealers into advisors, to serve fee-based accounts
- Revise advisor compensation structure and incentives away from commissions
- Set up fiduciary help desk and identify training required on new compliance and regulation

Invest in enabling processes and technology:

- Set up governance and compliance processes for advisers working with retirement accounts
- Explore potential acquisitions or partnerships with robo-advisors to serve low-balance accounts

Note: BICE is Best Interest Contract Exemption.
Source: InvestmentNews, Morningstar; A.T. Kearney analysis

2 Broker/dealers: They will be forced to scale down high-commission products and transition to fee-based advisory

Projected impact by 2020

		Assets	Revenues
i	Decline in commissions and 12B-1 income from retirement accounts	-	~\$1.5 billion (6%)
ii	Brokers shift to fee-based models (RIA, dual RIA)	~\$100 billion (3%)	~\$0.5 billion (3%)
iii	Shift of low-balance retirement accounts	~\$100 billion (2%)	~\$0.5 billion (2%)
vi	Slowdown in IRA rollovers	~\$50 billion (1%)	~\$0.5 billion (1%)
Total impact		~\$250 billion (6%)	~\$3 billion (11%)

Positioning for the future: key measures for broker/dealers

Optimize product and service strategy:

- Evaluate product portfolio and identify products that need to be phased out (such as fixed and variable annuities)
- Establish strategy for BICE guidelines and understand the risk of exacerbating poor customer perception
- Accelerate transition to fee-based services and evaluate account thresholds to continue serving

Revise people and talent strategy:

- Launch programs to improve advisor engagement and facilitate 360-degree communications (such as forming rule transition teams made up of advisors)
- Revise advisor compensation structure to offset losses from shift away from commissions
- Implement new retention programs to minimize the outflow to dual RIAs and RIAs

Invest in enabling processes and technology:

- Set up governance and compliance processes for advisers working with retirement accounts
- Explore potential acquisitions or partnerships with robo-advisors to serve low-balance accounts

Note: BICE is Best Interest Contract Exemption.
Source: InvestmentNews, Morningstar, A.T. Kearney analysis

3 Independent brokers/dealers: They face major disruption as smaller players strain to comply with the new rule

Projected impact by 2020

		Assets	Revenues
i Decline in commissions and 12B-1 income from retirement accounts	<ul style="list-style-type: none"> Commission-based retirement assets will be negatively impacted <ul style="list-style-type: none"> Retirement accounts constitute ~60% of assets Most assets are in commission-based accounts 	-	↓ ~\$2.0 billion (11%)
ii Brokers shift to fee-based models (RIA, dual RIA)	<ul style="list-style-type: none"> Increased regulatory scrutiny on commissions will trigger some to shift to advisory models (dual RIA, RIA) 	↓ ~\$200 billion (7%)	↓ ~\$1.5 billion (7%)
iii Shift of low-balance retirement accounts	<ul style="list-style-type: none"> Low-balance IRAs (~25% of assets) will not be valuable after the rule Independent broker/dealers will mostly stop serving low-balance IRA accounts 	↓ ~\$100 billion (3%)	↓ ~\$0.5 billion (3%)
vi Slowdown in IRA rollovers	<ul style="list-style-type: none"> Some brokers will avoid IRA rollovers, which account for ~\$400 billion annually 	↓ ~\$50 billion (1%)	↓ ~\$0.5 billion (1%)
Total impact		↓ ~\$350 billion (11%)	↓ ~\$4 billion (22%)











Positioning for the future: key measures for independent broker/dealers

- Optimize product and service strategy:**
- Accelerate transition towards fee-based services and evaluate account thresholds to continue serving
 - Establish strategy for BICE guidelines and understand risk of exacerbating poor customer perception
- Revise people and talent strategy:**
- Revise advisor compensation structure to offset losses from shift away from commissions
 - Implement new retention programs, and minimize outflow to dual RIAs and RIAs
- Invest in enabling processes and technology:**
- Set up governance and compliance processes for broker/dealers working with retirement accounts
 - Conduct careful diligence on all prospective technology investments, accounting for limited resource availability
- Explore M&A and partnerships:**
- Pursue mergers and acquisitions to build scale and the skills needed to adjust to the new requirements

Note: BICE is Best Interest Contract Exemption.
Source: InvestmentNews, Morningstar, A.T. Kearney analysis

4 Dual RIAs: With increased pressure on broker/dealers, “hybrids” will start pivoting toward RIAs

Projected impact by 2020

		Assets	Revenues
i Decline in commissions and 12B-1 income from retirement accounts	<ul style="list-style-type: none"> Commission-based retirement assets (~30% of assets) will be negatively impacted 	-	 ~\$0.5 billion (2%)
ii Brokers shift to fee-based models (RIA, dual RIA)	<ul style="list-style-type: none"> Increased regulatory scrutiny on commissions will trigger some broker/dealers to shift to dual RIA. 	 ~\$150 billion (7%)	 ~\$1.5 billion (7%)
iii Shift of low-balance retirement accounts	<ul style="list-style-type: none"> Low-balance IRAs will no longer make economic sense Dual-RIAs will discontinue service to certain low-balance commissioned IRA accounts 	 ~\$50 billion (2%)	 ~\$0.5 billion (2%)
iv Increased competition in fee-based models	<ul style="list-style-type: none"> The rule will increase competition in fee-based models lowering the annual management fees 	-	 ~\$1 billion (4%)
vi Slowdown in IRA rollovers	<ul style="list-style-type: none"> Due to fiduciary rule, some brokers/advisors will avoid IRA rollovers ~\$400B IRA rollovers annually 	 ~\$50 billion (1%)	 ~\$0.5 billion (1%)
Total impact		 ~\$100 billion (5%)	 ~\$0.5 billion (3%)

Positioning for the future: key measures for dual RIAs

Optimize product and service strategy:

- Accelerate transition to fee-based accounts
- Establish clear BICE guidelines and determine strategy to leverage exemption on existing products
- Evaluate economic thresholds for account balances and establish minimum balances required for service
- Assess potential impact on fees due to increased competition in RIA business and adjust proactively

Revise people and talent strategy:








- Determine broader strategy between RIA and broker/dealer business, with likely shift to enhancing advisor capabilities to serve fee-based accounts
- Implement and enhance retention programs, incorporating compensation structures
- Build recruiting strategy to attract advisors flowing out of brokers/dealers

Invest in enabling processes and technology:

- Set up governance and compliance processes for brokers/dealers working with retirement accounts

5 **RIAs:** With increased pressure on the broker/dealers, RIAs will grow as assets increase and advisors join their ranks

Projected impact by 2020

		Assets	Revenues
ii Brokers shift to fee-based models (RIA, dual RIA)	<ul style="list-style-type: none"> Many advisers will not want to use BICE because of the perception issue it creates with clients As a result, more brokers and hybrids will be joining the ranks of fee-only RIAs 	 ~\$250 billion (9%)	 ~\$3 billion (9%)
iv Increased competition in fee-based models	<ul style="list-style-type: none"> The rule will increase competition in RIAs because: <ul style="list-style-type: none"> There will be larger number of RIAs "Fiduciary" by itself will not be a unique value proposition anymore for RIAs Competition will likely lower the annual management fees 	-	 ~\$1.5 billion (5%)
vi Slowdown in IRA rollovers	<ul style="list-style-type: none"> Some advisers will avoid IRA rollovers, which account for ~\$400 billion annually 	 ~\$50 billion (1%)	 ~\$0.5 billion (1%)
Total impact		 ~\$250 billion (10%)	 ~\$1.5 billion (5%)

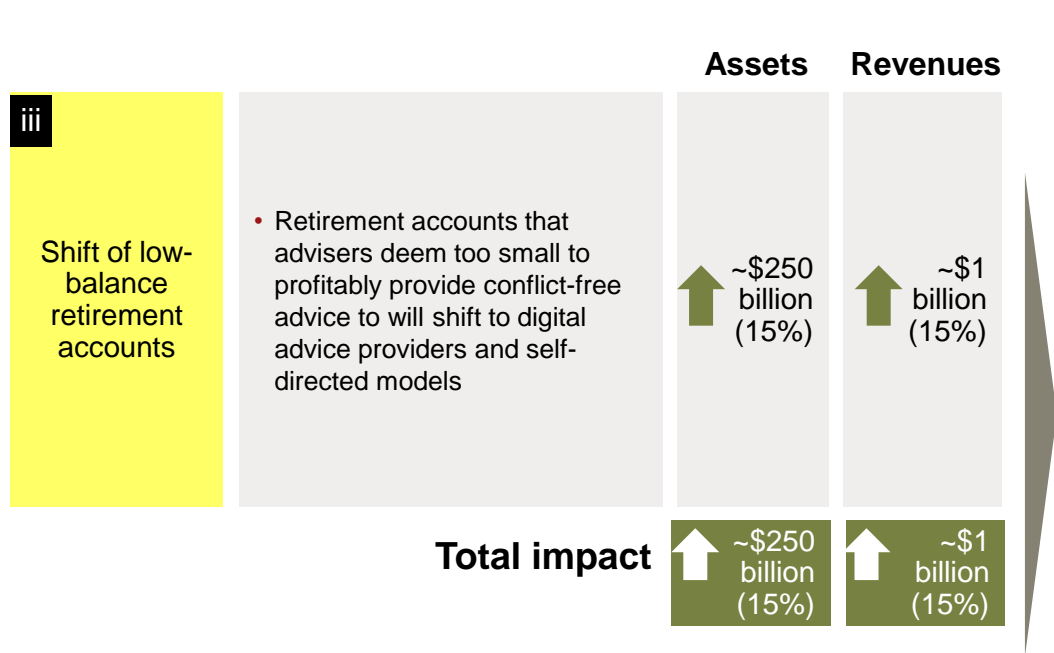
Positioning for the future: key measures for RIAs

- Optimize product and service strategy:**
- Assess 401(k) rollover options and fees to avoid scenarios where the fees the client will owe the RIA for managing the IRA will be greater than the existing plan's fees
 - Assess the potential impact on fees due to increased competition in the RIA business, and adjust proactively to remain competitive
- Revise people and talent strategy:**
- Build recruiting strategy to attract advisors flowing out of broker/dealers and hybrids
- Invest in enabling processes and technology:**
- Set up governance and compliance processes especially for rollover RIAs, i.e. "BICE lite"
- Explore M&A and partnerships:**
- Pursue acquisition opportunities as a cost of operational changes could be a challenge for small RIAs

Note: BICE is Best Interest Contract Exemption. Source: InvestmentNews; A.T. Kearney analysis

6 Robo-advisors: The rule should further accelerate the adoption of robo-advisory across the wealth management industry

Projected impact by 2020



Positioning for the future: key measures for robo-advisors

Optimize product and service strategy:

- Increase focus on developing services to accelerate market-share capture
- Make required adjustments to fee structures (as required), specifically for 401(k) rollover accounts
- Consider leveraging momentum from the fiduciary rule to accelerate expansion into:
 - Becoming retirement plan distributors
 - Managing deferred compensation plans (401(k), 403(b), 457)

Invest in enabling processes and technology

- Set up governance and compliance processes, especially for rollover RIAs

Explore M&A and partnerships:

- Consider targeted partnerships with or acquisitions by wirehouses, larger broker/dealers, and RIAs, as many will be courting and pursuing robo-advisory capabilities

7 Self-directed: Self-directed distribution will gain from increased asset flow

Projected impact by 2020

		Assets	Revenues
iii Shift of low-balance retirement accounts	<ul style="list-style-type: none"> Discount brokerages and robo-advisors will grab a share of the low-balance IRA assets that will be abandoned by full-service wealth management firms 	~\$200 billion (4%)	~\$1 billion (4%)
vi Slowdown in IRA rollovers	<ul style="list-style-type: none"> IRA rollovers (~\$400 billion annually) will slow down 	~\$50 billion (1%)	~\$0.5 billion (1%)
Total impact		~\$150 billion (4%)	~\$1 billion (4%)

Positioning for the future: key measures for self-directed

Optimize product and service strategy:

- Increase focus on developing services to accelerate market-share capture

Launch targeted marketing efforts:






- Increase profile among potential new clients with comprehensive services, and efficient and highly customized processes

Explore M&A opportunities and partnerships

- Explore external partnerships with robo-advisors to capture end-to-end value proposition

8 Retirement plan administrators: Retirement Plan Administrators will both benefit and suffer from the rule’s effects

Projected impact by 2020

		Assets	Revenues
v Pressure on 12b-1 fees	<ul style="list-style-type: none"> 12b-1 fees received by retirement plan administrators on mutual funds will decline; mutual funds account for \$3 trillion invested in 401(k) assets 	-	 ~\$1.5 billion (8%)
vi Slowdown in IRA rollovers	<ul style="list-style-type: none"> Some brokers will avoid rollovers, leading to a decline in IRA rollovers from 401(k)s ~\$400B assets are rolled over to IRAs annually A 10% decline in rollovers will prevent attrition of \$200 billion in 401(k) assets over five years 	 ~\$200 billion (3%)	 ~\$0.5 billion (3%)
Total impact		 ~\$200 billion (3%)	 ~\$1 billion (5%)

Positioning for the future: key measures for retirement plan administrators

Optimize product and service strategy:

- Review business model and services provided, particularly:
 - How to offset reductions in 12b-1 income from manufacturers
 - Fee structures and pricing for plan participants
 - Option to move away from role and focus on alternate businesses (such as manufacturing, advisory)

Enhance customer engagement

- The fee structure for plan participants will likely change as a result of the rule; this change needs to be shaped and positioned carefully to customers

9 **Manufacturers:** Mutual fund manufacturers will need to reassess their product portfolios and expense ratios

Projected impact by 2020

		Assets	Revenues
vii Decline in expense ratios	<ul style="list-style-type: none"> Advisors will prefer lower-cost mutual funds and ETFs Manufacturers will be taking actions to offer lower-cost mutual funds to be competitive <ul style="list-style-type: none"> Move away from front-end loads Lowering expense ratios 	-	Mutual funds ↓ ~\$7 trillion (6%) ETFs ↓ ~\$0.5 billion (15%)
viii Asset flow from mutual funds to exchange-traded-funds (ETFs)	<ul style="list-style-type: none"> ~\$1 trillion of assets could flow into ETFs by 2020, driven by: <ul style="list-style-type: none"> Preference for passive investment products by financial advisors due to “best interest” Higher adoption of robo-advisors 	Mutual funds ↓ ~\$1 trillion (6%) ETFs ↑ ~\$1 trillion (45%)	Mutual funds ↓ ~\$7.5 billion (6%) ETFs ↑ ~\$1.5 billion (45%)
Total impact: mutual funds		↓ ~\$1 trillion (6%)	↓ ~14.5 billion (12%)
Total impact: ETFs		↑ ~\$1 trillion (45%)	↑ ~\$1 billion (30%)

“Positioning for the Future” – Key Measures

Optimize product and service strategy:

- Adjust product offerings to investments that advisors and broker/dealers will use to populate IRAs and other retirement accounts, such as lower-cost passive investments
- Review fees and historic performance of products and move away from mutual funds with sales loads and higher fund expenses
- Enhance robo-advisory product offerings to harvest growth in robo-advisor assets

Explore M&A and partnerships

- Seek opportunities to acquire passive investment product capabilities (such as ETF manufacturers)

Launch targeted marketing efforts

- Promote improved product portfolios and options for advisors and investors, focused on low-fee, high-transparency, high-performance funds

Contents

- Overview: Department of Labor fiduciary rule update and impact on the industry
- Perspectives on how industry players should respond & reposition for the future
- **Immediate next steps and potential A.T. Kearney support options**

We assist Asset / Wealth Management players across all stages of profitability assessment, strategy formulation, and execution

Actions Required by Players – A.T. Kearney Offerings

“How will projected industry trends (e.g. DOL Rule) impact my business?”

Profitability Impact of Trends

- Estimate and map **top-line impact** of trends on business:
 - AUM flow (in / out of complex)
 - AUM shifts (across models, e.g., Direct vs. Managed, Mutual Funds vs. ETFs, etc.)
 - Pricing (across both Asset Mgmt. and Wealth Advisory)
- Estimate and map **cost impact** of trends on business:
 - Regulatory and Compliance Impacts
 - Other cost impacts
- Select customized deep-dives through **market surveys**:
 - Custom market surveys
 - Data analytics to leverage proprietary surveys

“What are my options and how should I respond?”

Strategic Options and Considerations

- Strategic options based on a review of trend impacts, such as:
 - Choices across Advisory models
 - Options to enhance / modify existing Advisory offerings
 - Asset Mgmt. model / mix options
 - Options to deal with regulatory / compliance requirements
- Evaluation of strategic options:
 - Economics modeling – AUM, pricing, costs, investment needs
 - Competitive assessments
 - Qualitative assessments – leadership agendas, brand, other considerations
 - Customized market and customer research
- Selection of go-forward options

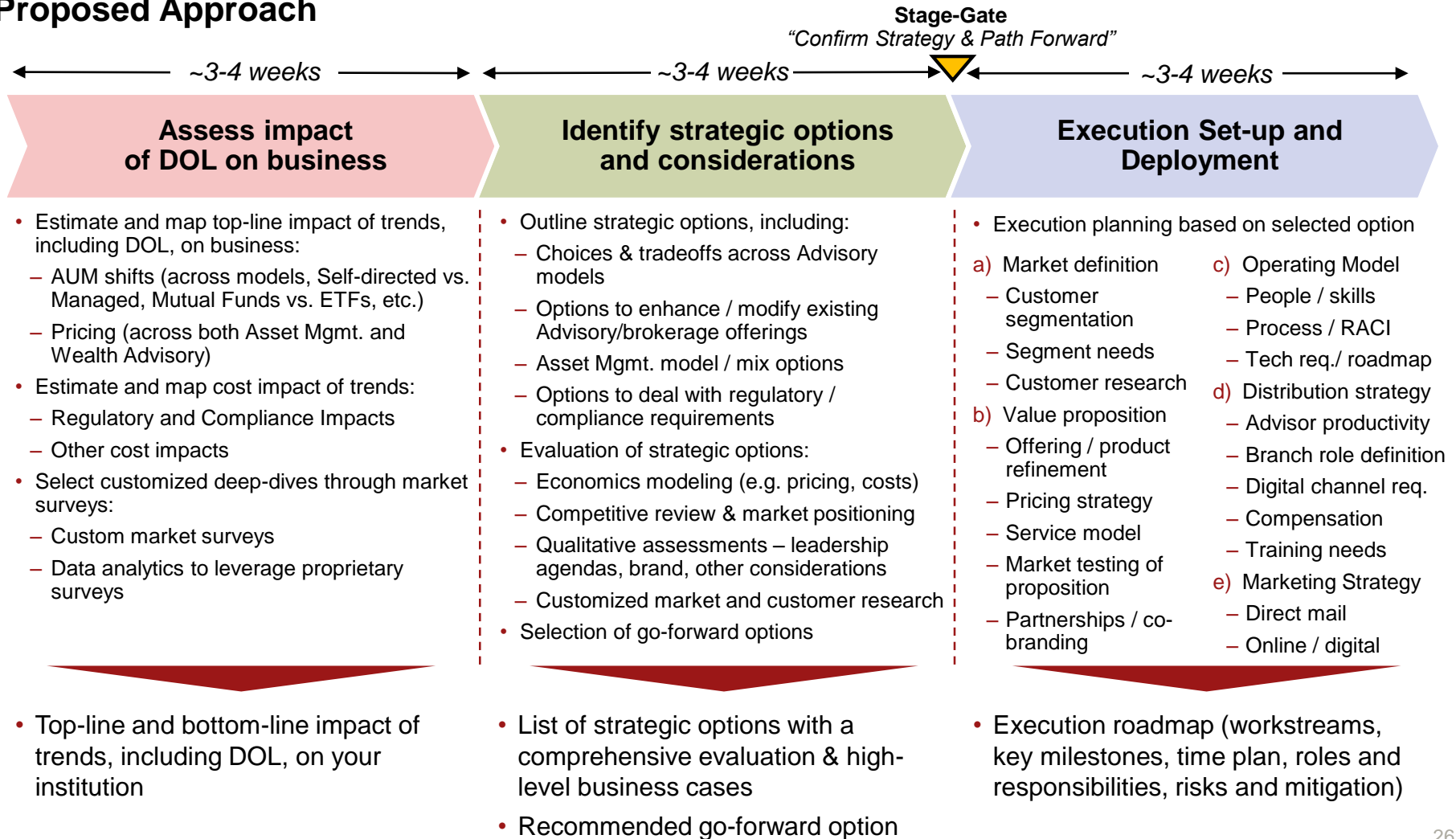
“How do I successfully design and execute my strategy?”

Execution Set-up and Deployment

- | | |
|--|---|
| <ul style="list-style-type: none"> ▪ Market definition <ul style="list-style-type: none"> ○ Customer segmentation ○ Segment needs ○ Customer research ▪ Value proposition <ul style="list-style-type: none"> ○ Offering / product refinement ○ Pricing strategy ○ Service model (e.g., human vs. digital, service tiering, roles, etc.) ○ Market testing of proposition ○ Partnerships / co-branding | <ul style="list-style-type: none"> ▪ Operating Model <ul style="list-style-type: none"> ○ People / skills ○ Process / RACI ○ Tech reqs. / roadmap ▪ Distribution strategy <ul style="list-style-type: none"> ○ Advisor productivity ○ Branch role definition ○ Digital channel requirements ○ Compensation and incentives ○ Training needs ▪ Marketing Strategy <ul style="list-style-type: none"> ○ Direct mail ○ Online / digital |
|--|---|

We typically co-refine and confirm our clients' mid to long-term wealth management and business strategies over ~9-12 weeks

Proposed Approach



Appendix

- **Remaining components of the A.T. Kearney DOL Fiduciary Rule Study**
 - **Positioning for the Future – Deep Dives**
 - Approach summary and model assumptions

1 Wirehouses: Wirehouses are well-positioned to reposition the business model toward fee-based advisory

Overall impact "Measured loss"

Positioning for the future: "Rethink and adjust"	
Lever	What to do...
Optimize product and service strategy	<ul style="list-style-type: none"> • Rethink the rule's impact on proprietary product portfolios. In most cases, consider reintroducing and accelerating the growth of proprietary products as a key incremental revenue source while winding down underperforming funds that will lose favor over time. • Establish clear BICE guidelines and determine strategy for leveraging the exemption on existing products (such as those targeting ultra-high-net-worth clients). • Convert commission-based IRA accounts to fee-based advisory accounts. • Evaluate accounts with both IRAs and non-tax advantaged assets. Determine strategies for managing different fiduciary responsibilities.
Revise people and talent strategy	<ul style="list-style-type: none"> • Focus on converting internal broker/dealers into advisors • Revise advisor compensation structure and incentives away from commissions • Explore potential opportunities to recruit and attract brokers from troubled broker-dealers in months leading up to and after the rule goes into effect.
Explore M&A opportunities and partnerships	<ul style="list-style-type: none"> • As part of shift to the advisory business, explore potential acquisitions of or partnerships with RIAs and robo-advisors to gain scale and broaden capabilities

1 Wirehouses: Targeted investments in key areas will help minimize losses to revenue and assets under management

Overall impact

“Measured loss”

Positioning for the Future: “Accelerate and magnify”

Lever	What to
Enhance Customer Engagement	<ul style="list-style-type: none"> • Build communication strategy to existing customers on impact of Fiduciary Rule and what is being done to “continue to preserve” their “Best Interest” • Accelerate efforts to improve the end-to-end customer service, leveraging the full scale and resources of Wirehouses (e.g. more personalized attention & service) • Improve linkage to broader financial services needs (e.g. personal banking, insurance)
Invest in Enabling Processes and Technologies	<ul style="list-style-type: none"> • Accelerate expansion of technology capabilities with specific focus on advanced analytics and reporting (e.g. proactive compliance issues, rollover account management) and Robo-advisory • Continuously find ways to maximize efficiency of day-to-day compliance management by automating the advisory workflow (e.g. Portfolio and Document Management, Performance and Fee Reporting)
Launch Targeted Marketing Efforts	<ul style="list-style-type: none"> • The rule will result in near-term asset outflow from Broker/Dealers – launch targeted marketing effort to: <ul style="list-style-type: none"> ○ Win new accounts ○ Attract top-performing brokers and advisors in particular from struggling Broker / Dealers

2 Broker/Dealers: Broker/Dealers will need to retool their business model and consider acquisitions to gain scale

Overall impact

“Slowing sales”

Positioning for the future: “Rethink and adjust”

Lever	What to do...
Optimize product and service strategy	<p><i>For long term:</i></p> <ul style="list-style-type: none"> • Rethink overall business model by (1) accelerating investment advisory services (fee-based) or (2) transitioning to becoming an operations or technology support platform for advisors (Turnkey Financial Planning Program) <p><i>For near term:</i></p> <ul style="list-style-type: none"> • Following a detailed review of the rule, evaluate product portfolio and identify products that need to be phased out due to existing fee or commission structure (such as annuities) • Establish a strategy for BICE guidelines and strategy, understanding additional risk of exacerbating poor customer perception of broker/dealers • Accelerate the transition to fee-based services and advisory, and evaluate account thresholds to continue serving (for example, accounts greater than \$200,000)
Revise people and talent strategy	<ul style="list-style-type: none"> • Launch programs to improve employee and advisor engagement; facilitate 360-degree communications (such as a rule transition team made up of advisors to discuss how to retain top performers and minimize disruption) • Revise advisor compensation structure to offset losses from shift away from commissions • Implement new retention programs (such as a bonus for new ideas to improve rule compliance); minimize outflow to RIAs and wirehouses
Explore M&A opportunities and partnerships	<ul style="list-style-type: none"> • Explore acquisitions of “cheap” independent broker/dealers struggling to comply to the rule • Form new external partnerships (such as robo-advisors) as part of a shift to fee-based advisory • Explore operations and technology support platforms (such as Garrett Planning Network)

2 **Broker/dealers:** Long-term investments aimed at courting assets from smaller IBDs as well as affiliated advisors will be important

Overall impact

“Slowing sales”

Positioning for the future: “Accelerate and magnify”

Lever	What to do...
Enhance customer engagement	<ul style="list-style-type: none"> • Build communication strategy to existing customers on the rule’s impact, with a special focus on: <ul style="list-style-type: none"> – Key differentiators of broker/dealers and reinforcing “quality of advice” – Options for customers with low-balanced accounts who may no longer be served – For affiliated advisors, revising fee structure and potential incremental value-added services and support (such as product customization, using robo-advisory and computer algorithms) • For larger broker/dealers, offer improved linkage to broader financial services needs (such as personal banking, life insurance)
Invest in enabling processes and technologies	<ul style="list-style-type: none"> • Continuously find ways to maximize the efficiency of day-to-day compliance management by automating the advisory workflow (such as portfolio and document management, performance and fee reporting) • Consider opportunity to enhance or build technology to support affiliated advisors (such as analytics and reporting, compliance support, marketing, and education)
Launch targeted marketing efforts	<ul style="list-style-type: none"> • Reposition marketing efforts on two fronts: <ul style="list-style-type: none"> – To customers: market scale and depth of capabilities to attract assets flowing away from smaller independent broker/dealers – To affiliated advisors: New service offerings, fiduciary commitments to advisory, and fee structure

3 Independent broker/dealers: Forced to fundamentally rethink their business models

Overall impact "Significant disruption"

Positioning for the future: "Rethink and adjust"	
Lever	What to do...
Optimize product and service strategy	<p><i>For Long Term</i></p> <ul style="list-style-type: none"> Rethink overall business model by (1) accelerating investment advisory services (fee-based), (2) transitioning to becoming an operations or technology support platform for advisors (Turnkey Financial Planning Program), or (3) shutting down business <p><i>For Near-Term</i></p> <p style="text-align: center;"><i>Similar actions to broker/dealers</i></p>
Revise people and talent strategy	<p style="text-align: center;"><i>Similar actions to broker/dealers</i></p>
Explore M&A opportunities and partnerships	<p>For larger independent broker/dealers:</p> <p style="text-align: center;"><i>Similar actions to broker/dealers</i></p> <p>For smaller independent broker/dealers:</p> <ul style="list-style-type: none"> Consider being acquired by larger broker/dealers or dual RIAs, with initial activities including: <ul style="list-style-type: none"> Engaging bankers and lawyers to assess options Approaching targeted broker/dealers and dual RIAs for preliminary conversations

3 Independent broker/dealers: The smaller IBDs will be faced with the greatest challenges

Overall impact "Significant disruption"

Positioning for the future: "Accelerate and magnify"	
Lever	What to do...
Enhance customer engagement	<p><i>Similar actions to broker/dealers</i></p>
Invest in enabling Processes and Technologies	<p>For larger independent broker/dealers</p> <p><i>Similar actions to broker/dealers</i></p> <p>For smaller independent broker/dealers</p> <ul style="list-style-type: none"> • Conduct careful diligence on all prospective technology investments – accounting for limited resource availability • Consider technology partnerships to augment internal capabilities
Launch targeted marketing efforts	<p>For larger independent broker/dealers</p> <p><i>Similar actions to Broker / Dealers</i></p> <p>For smaller independent broker/dealers</p> <ul style="list-style-type: none"> • Focus outreach and marketing on: <ul style="list-style-type: none"> – Business model focused on long-term relationships – Personalized and often regionalized services

4 **Dual RIAs:** Dual RIAs will focus on growing the advisory business through attracting new advisors and targeted acquisitions

Overall impact **“Business model shift”**

Positioning for the future: “Rethink and adjust”	
Lever	What to do...
Optimize product and service strategy	<ul style="list-style-type: none"> • Determine broader strategy and “level of emphasis” between RIA and broker/dealers, with likely shift to enhancing advisor capabilities and growing RIA revenue • Establish clear BICE guidelines and determine strategy for leveraging exemption on existing products (such as products targeting UHNW clients) • Determine new product pipeline, using BICE in addition to computer-based asset-allocation models • Evaluate economic thresholds for account balances, establishing the minimum balances required for service • Assess the potential impact on fees due to increased competition in the RIA business; adjust proactively to remain competitive
Revise people and talent strategy	<ul style="list-style-type: none"> • Build recruiting strategy to attract advisors flowing out of broker-dealers • Implement and enhance retention programs incorporating changes to existing compensation structures (such as advisor recognition, performance bonuses) • Optimize business and staffing plan to ensure adequate support and resource to handle increased business and assets
Explore M&A opportunities and partnerships	<ul style="list-style-type: none"> • Assess acquisition targets, particularly “cheap” independent broker/dealers (focus on complementary books of business) • Similar to wirehouses and larger broker/dealers, consider partnerships or acquisitions with robo-advisory firms

4 Dual RIAs: Dual RIAs will market their scale and “deeper bench” vs. traditional RIAs as a key differentiator

Overall impact **“Business model shift”**

Positioning for the future: “Accelerate and magnify”	
Lever	What to do...
Enhance customer engagement	<ul style="list-style-type: none"> • Enhance customer service and engagement by better using the strengths of both broker-dealer and RIA models, including: <ul style="list-style-type: none"> – Improved access to and knowledge of investment products (including select high-fee products) – Relatively streamlined transactions and faster response
Invest in enabling processes and technologies	<ul style="list-style-type: none"> • Balance technology investments, leveraging existing infrastructure supporting RIAs • Similar to broker/dealers, continuously find ways to maximize efficiency of day-to-day compliance management by automating the advisory workflow (such as portfolio and document management, performance and fee reporting) • In addition, invest in improving technology and data linkage across the broker/dealer and RIA businesses (such as portfolio management platform)
Launch targeted marketing efforts	<ul style="list-style-type: none"> • Launch marketing targeted at driving several key messages: <ul style="list-style-type: none"> – Deeper and broader capabilities and knowledge being dually registered – Streamlined transactions and faster response – To advisors: Scale, in addition to favorable compensation and retention programs

5 **RIAs:** With the new rule, RIAs can gain market share rapidly but should also be cautious about certain rollover accounts

Overall impact **“Relative win”**

Positioning for the future: “Rethink and adjust”	
Lever	What to do...
Optimize product and service strategy	<ul style="list-style-type: none"> • Determine new product pipeline, leveraging BICE (if necessary) in addition to computer-based asset-allocation models • Evaluate economic thresholds for account balances, establishing the minimum balances required for service • Assess the potential impact on fees due to increased competition in RIA business, and adjust proactively to remain competitive
Revise people and talent strategy	<p style="text-align: center;"><i>Similar actions to dual RIAs</i></p>
Explore M&A opportunities and partnerships	<p style="text-align: center;"><i>Similar actions to dual RIAs</i></p>

5 RIAs: With the new rule, RIAs can gain market share rapidly but should also be cautious about certain rollover accounts

Overall impact **“Relative win”**

Positioning for the future: “Accelerate and magnify”	
Lever	What to do...
Enhance customer engagement	<ul style="list-style-type: none"> • Continue to focus on finding new ways to engage customers to reinforce the ongoing fiduciary and best-interest standards prior to the rule. Examples include: <ul style="list-style-type: none"> – Communication on the impact of the rule (minimal from the customer’s perspective) – Summary communication of fee comparisons vs. performance (RIAs vs. broker/dealers) • Invest in reinforcing personal and long-term relationship
Invest in enabling processes and technologies	<ul style="list-style-type: none"> • Minimal incremental investments required • If resources are available, several technology investments may be worth exploring <ul style="list-style-type: none"> – Enhanced analytics and reporting, particularly around information disclosures, fees, and performance – Improved customer portals, such as information access and communication with advisors – Robo-advisory capabilities and partnerships
Launch targeted marketing efforts	<ul style="list-style-type: none"> • Launch marketing targeted at driving several key messages: <ul style="list-style-type: none"> – Advice has always been in the best interest of customers – Opportunity to build personal, long-term relationships – To advisors: Scale, in addition to favorable compensation and retention programs

6 **Robo-advisors:** Robo-advisors stand to gain significantly during this transition

Overall impact **“Accelerated growth”**

Positioning for the future: “Rethink and adjust”	
Lever	What to do...
Optimize product and service strategy	<ul style="list-style-type: none"> • Increase focus on developing services to accelerate market-share capture (such as spending tracker, investment education to customers) • Make required adjustments to fee structures (as required), specifically for rollover accounts • Consider tapping into the momentum from the fiduciary rule to accelerate expansion into: <ul style="list-style-type: none"> – Becoming retirement plan distributors – Managing deferred compensation plans (401(k), 403(b), 457)
Revise people and talent strategy	N/A
Explore M&A opportunities and partnerships	<ul style="list-style-type: none"> • Consider targeted partnerships with or being acquired by wirehouses, larger broker/dealers, and RIAs; many will be courting and pursuing Robo capabilities

6 Robo-Advisors: Targeted marketing efforts can further accelerate robo-advisor adoption

Overall impact **“Accelerated growth”**

Positioning for the future: “Accelerate and magnify”	
Lever	What to do...
Enhance customer Engagement	Minimal impact
Invest in enabling processes and technologies	Minimal impact
Launch targeted marketing efforts	<ul style="list-style-type: none"> • Increase profile among both potential clients and advisors <ul style="list-style-type: none"> – For clients: Differentiated services, efficient and highly customized products – For advisors: Easy partnerships or integration into wirehouse, broker/dealer, RIA infrastructure and processes

8 Retirement plan distributors: Retirement plan distributors will need to re-evaluate their business models and revenue streams

Overall impact **“Marginal win”**

Positioning for the future: “Rethink and adjust”	
Lever	What to do...
Optimize product and service strategy	<ul style="list-style-type: none"> Review fundamental business model and services provided, particularly: <ul style="list-style-type: none"> How to offset reductions in 12b-1 income from manufacturers Fee structures from plan participants Option to move away from role and focus on alternate businesses (such as manufacturing, advisory)
Revise people and talent strategy	<p>Minimal Impact</p> <ul style="list-style-type: none"> Depending on resulting business model shifts, the supporting workforce will be impacted
Explore M&A opportunities and partnerships	N/A

8 Retirement Plan Distributors: Focus should be placed on growing other parts of the business

Positioning for the Future: “Accelerate & Magnify”

Overall Impact	“Marginal Win”
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Positioning for the Future
(What Industry Leaders are Doing...)

Positioning for the future: “Accelerate and magnify”	
Lever	What to do...
Enhance customer Engagement	<ul style="list-style-type: none"> • The fee structure for plan participants will likely change as a result of the rule – these changes need to be shaped and positioned carefully to customers
Invest in enabling processes and technologies	Minimal Impact
Launch targeted marketing efforts	Minimal Impact <ul style="list-style-type: none"> • Changes to fee structures will require some marketing and communication coordination – particularly emphasizing: <ul style="list-style-type: none"> – Why there was a change to the fee structure – The value the distributors provide to plan participants

9 Manufacturers: Mutual fund manufacturers will need to reassess their product portfolios and expense ratios

Overall impact **“Revenue disruption”**

Positioning for the future: “Rethink and adjust”	
Lever	What to do...
Optimize product and service strategy	<ul style="list-style-type: none"> Adjust product offerings to investments that advisers and broker/dealers will use to populate IRAs and other retirement accounts, such as lower-cost passive investments Review fees and historic performance of products, and move away from mutual funds with sales loads and higher fund expenses Enhance robo-advisory product offerings to harvest growth in robo-advisor assets
Revise people and talent strategy	Minimal impact
Explore M&A opportunities and partnerships	<ul style="list-style-type: none"> Seek opportunities to acquire passive investment product capabilities (such as ETF manufacturers)

9 Manufacturers: Mutual fund manufacturers will need to reassess their product portfolios and expense ratios

Overall impact **“Revenue disruption”**

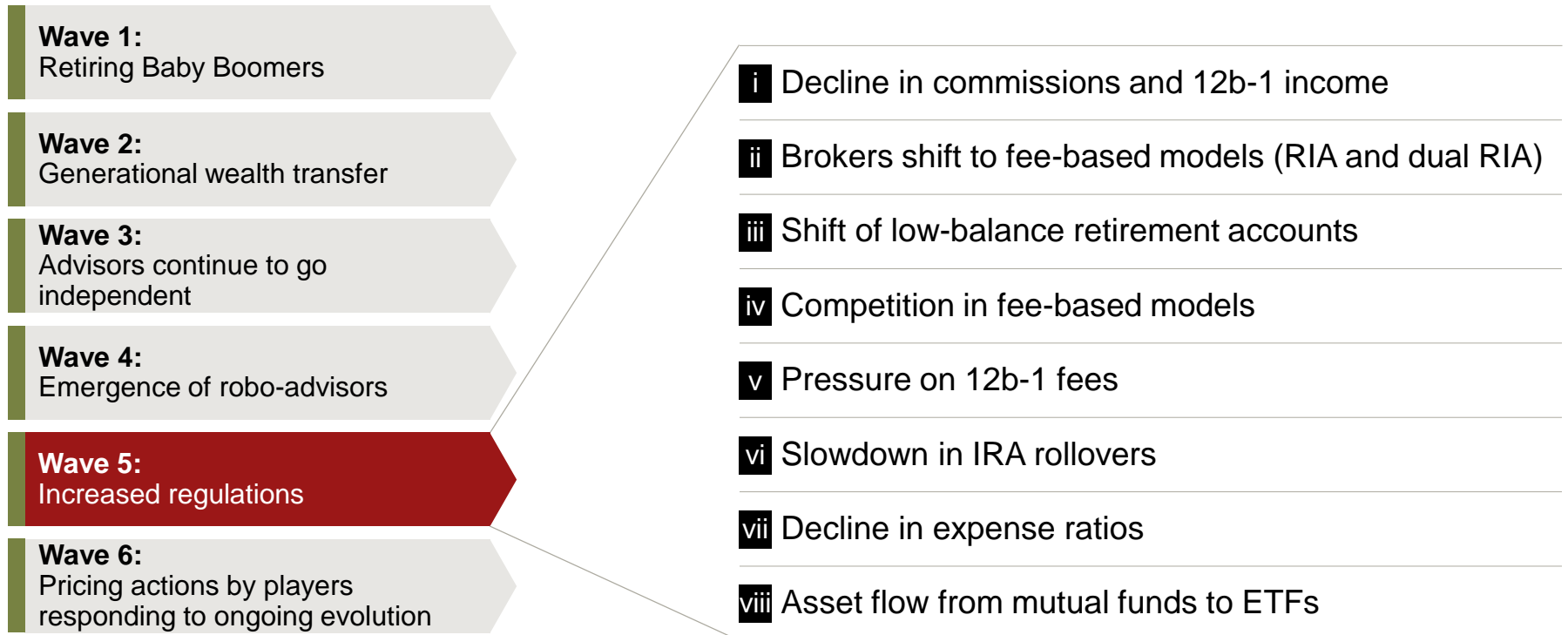
Positioning for the future: “Accelerate and magnify”	
Lever	What to do...
Enhance customer Engagement	Minimal impact
Invest in enabling processes and technologies	Minimal impact
Launch targeted marketing efforts	<ul style="list-style-type: none"> Promote improved product portfolio and options for advisors and investors, focused on low-fee, high-transparency and performing funds

Appendix

- **Remaining components of the A.T. Kearney DOL Fiduciary Rule Study**
 - Positioning for the Future – Deep Dives
 - **Approach summary and model assumptions**

The fiduciary rule's impact on the industry is estimated based on eight drivers within "Increased regulations" Wave of Change

Our Approach: Waves of Change



Impact of the fiduciary rule on industry assets, by cause

	2015 assets	i Commission decline	ii Advisor shift	iii Low-balance asset shift	iv Competition on fees	v Pressure on 12b-1	vi Slowdown in IRA rollovers	vii Expense ratio decline	viii Shift to ETFs	Total impact		2020 assets after DOL
	\$T	\$T	\$T	\$T	\$T	\$T	\$T	\$T	\$T	\$T	%	\$T
Distribution Total	\$28.0	-	\$0.0	\$0.0	-	-	\$0.0	-	-	\$0.0	0%	\$28.0
Traditional advisors	\$16.8	-	\$0.0	-\$0.4	-	-	-\$0.2	-	-	-\$0.6	-3%	\$16.2
Wirehouse	\$5.7	-	-\$0.1	-\$0.2	-	-	-\$0.1	-	-	-\$0.3	-5%	\$5.4
Broker/dealers	\$4.2	-	-\$0.1	-\$0.1	-	-	\$0.0	-	-	-\$0.2	-6%	\$4.0
Independent broker/dealers	\$3.0	-	-\$0.2	-\$0.1	-	-	\$0.0	-	-	-\$0.3	-11%	\$2.7
Dual RIAs	\$1.6	-	\$0.2	-\$0.1	-	-	\$0.0	-	-	\$0.1	5%	\$1.7
RIAs	\$2.2	-	\$0.2	\$0.0	-	-	\$0.0	-	-	\$0.2	10%	\$2.5
Robo-advisors	\$0.1	-	-	\$0.2	-	-	\$0.0	-	-	\$0.2	211%	\$0.3
Self-directed	\$4.4	-	-	\$0.2	-	-	\$0.0	-	-	\$0.2	4%	\$4.6
Retirement plan admins	\$6.8	-	-	-	-	-	\$0.2	-	-	\$0.2	3%	\$7.0
Manufacturers	\$18.9	-	-	-	-	-	-	-	\$0.0	\$0.0	0%	\$18.9
Mutual funds	\$16.7	-	-	-	-	-	-	-	-\$1.0	-\$1.0	-6%	\$15.7
Exchange-traded funds	\$2.2	-	-	-	-	-	-	-	\$1.0	\$1.0	45%	\$3.2

Impact of fiduciary rule on industry revenues, by cause

	2015 revenues	i Commission decline	ii Advisor shift	iii Low-balance asset shift	iv Competition on fees	v Pressure on 12b-1	vi Slowdown in IRA rollovers	vii Expense ratio decline	viii Shift to ETFs	Total impact		2020 revenues after DOL
	\$B	\$B	\$B	\$B	\$B	\$B	\$B	\$B	\$B	\$B	%	\$B
Distribution Total	\$181	-\$4.7	\$2.1	-\$1.3	-\$2.9	-	-\$0.9	-	-	-\$9.3	-5%	\$172
Traditional advisors	\$139	-\$4.7	\$2.1	-\$3.2	-\$2.9	-	-\$1.3	-	-	-\$10.1	-7%	\$129
Wirehouse	\$50	-\$1.0	-\$0.8	-\$1.3	-\$0.6	-	-\$0.5	-	-	-\$4.1	-8%	\$46
Broker/dealers	\$25	-\$1.4	-\$0.5	-\$0.7	\$0.0	-	-\$0.2	-	-	-\$2.8	-11%	\$23
Independent broker/dealers	\$18	-\$1.9	-\$1.3	-\$0.6	\$0.0	-	-\$0.2	-	-	-\$4.0	-22%	\$14
Dual RIAs	\$17	-\$0.5	\$1.6	-\$0.6	-\$0.9	-	-\$0.2	-	-	-\$0.5	-3%	\$17
RIAs	\$28	-	\$3.1	\$0.0	-\$1.5	-	-\$0.3	-	-	\$1.4	5%	\$29
Robo-advisors	\$0	-	-	\$0.9	-	-	\$0.0	-	-	\$0.9	211%	\$1
Self Directed	\$22	-	-	\$1.0	-	-	-\$0.2	-	-	\$0.8	4%	\$23
Retirement plan admins	\$20	-	-	-	-	-\$1.5	\$0.6	-	-	-\$0.9	-5%	\$19
Manufacturer	\$129	-	-	-	-	-	-	-\$7.5	-\$6.0	-\$13.5	-10%	\$115
Mutual funds	\$125	-	-	-	-	-	-	-\$7.0	-\$7.5	-\$14.5	-12%	\$111
Exchange-traded funds	\$3	-	-	-	-	-	-	-\$0.5	\$1.5	\$1.0	30%	\$4