

# **Review of Selected Studies and Comments in Response to the Department of Labor's Conflict of Interest 2015 Proposed Rule and Exemptions**

March 4, 2016

Advanced Analytical Consulting Group, Inc.

<b>Karthik Padmanabhan, MBA, MS</b>	<b>Constantijn Panis, PhD</b>	<b>Timothy J. Tardiff, PhD</b>
312-551-9001	213-784-6400	617-827-4043
karpad@aacg.com	stanpanis@aacg.com	timtardiff@aacg.com

## **ABSTRACT**

In April 2015, the U.S. Department of Labor (DOL) published a Conflict of Interest Proposed Rule.<sup>1</sup> The DOL received numerous comments. This document reviews six studies that were submitted among the comments by NERA Economic Consulting, Oliver Wyman, the Investment Company Institute, Compass Lexecon, Robert Litan and Hal Singer of Economists Inc., and Quantria Strategies.

We first discuss a number of common themes that were raised in the studies and then separately address each of the six studies with a summary of our opinions, a synopsis of the study, and a discussion of the pertinent arguments. We generally find the studies lacking in rigor, failing to recognize emerging alternatives to traditional offerings of investment advice, incorrectly equating the benefits of conflicted advice to those of non-conflicted advice, or suffering from logical fallacies. None of the studies offer compelling arguments against implementation of the DOL's Conflict of Interest Proposed Rule.

---

<sup>1</sup> See Federal Register, Volume 80, p. 21928, available at <http://webapps.dol.gov/FederalRegister/PdfDisplay.aspx?DocId=28201>.

## CONTENTS

<b>Abstract</b> .....	<b>i</b>
<b>Abbreviations</b> .....	<b>iii</b>
<b>1. Introduction</b> .....	<b>1</b>
<b>2. Common Themes</b> .....	<b>3</b>
Common Theme 1: Investors with Higher Balances Will Migrate to Higher-Cost Fee-Based Accounts .....	3
Common Theme 2: Investors with Low Balances Will Lose Access to Advice .....	5
Common Theme 3: Lack of Advice Will Cause Investors to Make Mistakes and Save Less .....	8
Common Theme 4: The Academic Literature Is Misapplied .....	9
<b>3. NERA Economic Consulting</b> .....	<b>12</b>
Summary .....	12
Synopsis .....	13
Discussion .....	14
<b>4. Oliver Wyman</b> .....	<b>22</b>
Summary .....	22
Synopsis .....	23
Discussion .....	23
<b>5. Investment Company Institute</b> .....	<b>32</b>
Summary .....	32
Synopsis .....	32
Discussion .....	33
<b>6. Compass Lexecon</b> .....	<b>41</b>
Summary .....	41
Synopsis .....	42
Discussion .....	42
<b>7. Litan and Singer</b> .....	<b>45</b>
Summary .....	45
Synopsis .....	47
Discussion .....	47
<b>8. Quantria Strategies</b> .....	<b>56</b>
Summary .....	56
Synopsis .....	56
Discussion .....	57
<b>9. References</b> .....	<b>64</b>
<b>Disclaimer</b> .....	<b>69</b>

---

## ABBREVIATIONS

bps	Basis points (1 bps = 0.01%)
DB	Defined benefit
DC	Defined contribution
DOL	U.S. Department of Labor
ERISA	Employee Retirement Income Security Act
EBRI	Employee Benefit Research Institute
GAO	General Accounting Office
ICI	Investment Company Institute
IRA	Individual Retirement Account (or Individual Retirement Arrangement)
RIA	Regulatory impact analysis
S&P	Standard & Poors
SCF	Survey of Consumer Finances
SEC	Securities and Exchange Commission
SIFMA	Securities Industry and Financial Markets Association

## 1. INTRODUCTION

In April 2015, the DOL published a Conflict of Interest Proposed Rule (“Proposed Rule”)<sup>2</sup> along with a Regulatory Impact Analysis (DOL 2015).<sup>3</sup> This document contains reviews of six studies and supplemental materials that were submitted among the many comments that the DOL received.

- *NERA Economic Consulting*: SIFMA submitted comments, which included a comment by NERA Economic Consulting (NERA 2015a).<sup>4</sup> In response to questions from the DOL, NERA provided additional details in a memorandum (NERA 2015b).<sup>5</sup> No individual authors are listed on NERA (2015a). The author of NERA (2015b) is Patrick Conroy.
- *Oliver Wyman*: Several financial services firms jointly commented based on a study by Oliver Wyman Inc. titled “The role of financial advisors in the US retirement market” (Oliver Wyman 2015).<sup>6</sup> No individual authors are listed.
- *Investment Company Institute*: Brian Reid and David W. Blass of ICI filed a July 21, 2015 letter “re: RIN 1210-AB32: Regulatory Impact Analysis, Definition of the Term “Fiduciary”; Conflict of Interest Rule—Retirement Advice” (ICI 2015a).<sup>7</sup> In response to questions from the DOL, Reid and Blass provided additional details in two letters of September 24, 2015 (ICI 2015b)<sup>8</sup> and December 1, 2015 (ICI 2015c).
- *Compass Lexecon*: Counsel for Primerica, Inc. submitted a study by Compass Lexecon titled “Tax Consequences to Investors Resulting from Proposed Rules Relating to Financial Representative Fiduciary Status” (Compass Lexecon 2015).<sup>9</sup> No individual authors are listed.
- *Litan and Singer*: The Capital Group submitted a study by Robert Litan and Hal Singer of Economists Inc. on “Good Intentions Gone Wrong: The Yet-To-Be Recognized Costs of the Department of Labor’s Proposed Fiduciary Rule” (Litan and Singer 2015a).<sup>10</sup> In response to questions from the DOL, Litan and Singer provided additional details in a letter of September 21, 2015 (Litan and Singer 2015b).<sup>11</sup>
- *Quantria Strategies*: On behalf of a group of clients, Davis & Harman LLP submitted a study by Quantria Strategies LLC titled “Unintended Consequences: Potential of the DOL Regulations to Reduce Financial Advice

---

<sup>2</sup> See Federal Register, Volume 80, p. 21928, available at <http://webapps.dol.gov/FederalRegister/PdfDisplay.aspx?DocId=28201>.

<sup>3</sup> Available at <http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf>.

<sup>4</sup> Available at <http://www.dol.gov/ebsa/pdf/1210-AB32-2-00506.pdf>.

<sup>5</sup> Available at <http://www.dol.gov/ebsa/pdf/1210-AB32-2-03079.pdf>.

<sup>6</sup> Available at <http://www.dol.gov/ebsa/pdf/1210-AB32-2-00515.pdf>.

<sup>7</sup> Available at <http://www.dol.gov/ebsa/pdf/1210-AB32-2-00749.pdf>.

<sup>8</sup> Available at <http://www.dol.gov/ebsa/pdf/1210-AB32-2-03056.pdf>.

<sup>9</sup> Available at <http://www.dol.gov/ebsa/pdf/1210-AB32-2-00615.pdf>.

<sup>10</sup> Available at <http://www.dol.gov/ebsa/pdf/1210-AB32-2-00517.pdf>.

<sup>11</sup> Available at <http://www.dol.gov/ebsa/pdf/1210-AB32-2-02967.pdf>.

and Erode Retirement Readiness" (Quantria 2015).<sup>12</sup> No individual authors are listed.

Several studies made the same or similar assertions or arguments. We address some of these common themes in Section 2. Sections 3 through 8 review the six studies, each with a summary of our opinions, a synopsis of the study, and a detailed discussion.

---

<sup>12</sup> Available at <http://www.dol.gov/ebsa/pdf/1210-AB32-2-00746.pdf>.

## 2. COMMON THEMES

Several studies reviewed in this document made similar assertions or arguments. This section discusses such common themes. They include:

1. The Proposed Rule would force IRA investors with higher balances to migrate to higher-cost fee-based accounts;
2. The Proposed Rule would force IRA investors with low balances to lose access to advice;
3. Lack of advice prompted by the Proposed Rule would cause investors to make mistakes and save less; and
4. The Regulatory Impact Analysis (RIA) misapplies the academic literature.

We discuss these themes in turn, but first define typical IRA account types. IRAs may be held in arrangements through which the account holder has access to financial advice, such as a brokerage account or an advisory account. A brokerage account charges commissions, which may include a fixed amount per trade, a front-end or back-end load charge, annual 12b-1 fees, et cetera. These amounts (and the shares that are paid to the broker) may differ across financial products, which may give rise to conflicts of interest for brokers. In contrast, an advisory account typically charges a percentage of assets under management irrespective of the financial products in which the account balance is invested. This annual fee is also known as a wrap fee. IRAs may also be held in arrangements without professional advice, such as in a discount brokerage account. Consistent with most commentators, we use the term “brokerage account” for accounts that include access to advice and “discount brokerage account” for accounts without access to advice.

### ***Common Theme 1: Investors with Higher Balances Will Migrate to Higher-Cost Fee-Based Accounts***

The first and second common themes follow from the premise that the Proposed Rule would make current commission-based brokerage accounts unworkable, forcing the closure of such accounts. To preserve access to advice, some IRAs would migrate to fee-based advisory accounts. According to the first common theme, since a financial institution’s main source of revenue from advisory accounts is an annual percentage of assets, migration would be profitable for larger accounts only. Conversely, the second common theme posits that smaller accounts would migrate to a discount brokerage account and lose access to advice.

Several studies argue that the move to advisory accounts would imply higher costs for the IRA account holder. Examples include the following: “This suggests that investors would pay more if moved to fee-based accounts” (NERA 2015a, p. 6); “Almost all retail investors would face increased costs (73% to 196% on average) from providers shifting clients to a fee-based advisory model” (Oliver Wyman 2015, p. 38); “if the account is large enough, move to an advisory relationship, which may increase fees, especially for buy and hold investors” (Quantria 2015, p. 7).

These claims are not based on empirical evidence of investor responses to fee changes. Further, they do not accurately reflect the empirical evidence about the full cost to investors of brokerage accounts. Instead, incorrect cost estimates and a

flawed assumption of static prices and service levels result in biased cost comparisons. First, the difference in fees charged to investors in advisory accounts versus brokerage accounts is smaller than the studies purport to document. Second, brokerage account holders have opted for a lower average service level than holders of advisory accounts and may continue to be served at a lower level (and at a lower cost) after migration.

Oliver Wyman (2015), Litan and Singer (2015a), and Quantria (2015) cite a 2011 study by Oliver Wyman which tabulated higher fees for advisory than for brokerage accounts. However, that comparison accounted for direct expenses only. It ignored expenses that the account holder paid to a third party which shared the proceeds with the broker. In the words of Oliver Wyman (2011, p. 22), the comparison “[e]xcludes marketing and distribution, shareholder services, and other fees not directly paid by investors.” The excluded cost components are predominantly relevant for brokerage accounts, i.e., the comparison is biased to make brokerage accounts look less expensive. The excluded cost components can be substantial. For example, 12b-1 fees and shareholder service fees can run as high as 100 bps (SEC 2015).

NERA (2015a) analyzed a proprietary data set of about 63,000 IRAs in brokerage and advisory accounts. It, too, compared expenses of advisory accounts to those of brokerage accounts and concluded that advisory accounts were more expensive. And like Oliver Wyman (2011), NERA (2015a, p. 4) biased the comparison by considering only direct fees: “Fees exclude revenue that the firm may receive indirectly from the account-holder, such as markup/markdown revenue or 12b-1 fees.” These and other indirect revenue components vary across products, tend to constitute conflicted compensation, and their exclusion therefore makes brokerage accounts appear less expensive than they really are. In a follow-up memorandum prompted by questions from the DOL, NERA (2015b) defended the exclusion of indirect fees with the assertion that its data set did not contain information related to such fees. However, the detailed, account-level data that NERA compiled presumably included information on fund positions, and 12b-1 fees for individual funds are readily available from Morningstar and other sources. In other words, NERA’s fee comparison is biased, making brokerage investments appear to have lower costs than they actually do. NERA acknowledged the bias and did not do anything to mitigate it even though doing so would have been relatively straightforward with publicly available information.

While Oliver Wyman’s and NERA’s expense comparisons bias brokerage expenses downward, even if average expenses for advisory accounts were higher than for brokerage accounts, a simple comparison of average expenses in brokerage and advisory accounts would not support a conclusion on whether expenses in brokerage accounts would rise or fall when migrated to advisory accounts. The level of activity in brokerage accounts tends to be much lower than that in advisory accounts, and the level of service required to maintain those accounts is correspondingly lower. For example, NERA (2015a) reported that the median brokerage account in its data file traded 6 times in 2014, compared with 57 times for the median advisory account. Advisory accounts tend to have higher balances, which explains some of the difference, but NERA (2015a) found trading frequencies among brokerage accounts to be much lower than among advisory accounts at all reported balance ranges. NERA (2015a, p. 7) presented its results in terms of self-selection of investors: “Thus, the data are consistent with the idea that investors who expect to trade often rationally choose fee-based accounts whereas those that do not trade often are likely to choose commission-based accounts.” None of the studies we reviewed suggested



that trading patterns would change if, as asserted, brokerage accounts are converted into advisory accounts. In other words, financial institutions may be expected to continue to provide the same, relatively low level of service after conversion as they currently provide to brokerage accounts.

In a competitive market, a lower level of service should of course be provided at a lower cost. Indeed, as observed by Council of Economic Advisers (2015, p. 21):

The cost of advice depends primarily on the resources necessary to provide it—the adviser’s time, IT infrastructure, and other inputs—rather than the form of the adviser’s compensation. Thus, an adviser receiving payment through non-conflicted structures should be able to provide advice at the same cost as an adviser receiving conflicted payments, as long as the inputs in time and infrastructure are equal.

The studies reviewed in this document failed to recognize that services currently provided to brokerage accounts should cost roughly the same in advisory accounts. For example, ICI (2015a, p. A-1) assumed—without motivation—that current pricing models will carry over: “The difference in the fees [between advisory and brokerage accounts] is roughly 60 basis points [...], which is the additional amount that each investor moving to a fee-based account would pay.” Instead of retaining their current pricing structures, financial institutions may be expected to offer modified account types that avoid fees on services that newly migrated investors do not demand.

## ***Common Theme 2: Investors with Low Balances Will Lose Access to Advice***

As noted above, several studies adopted the premise that the Proposed Rule would make current commission-based brokerage accounts unworkable and that it would force the closure of such accounts. The studies argued that larger IRAs would migrate to fee-based advisory accounts, but that such accounts would not be profitable for smaller accounts. Instead, they argue, smaller accounts would migrate to an account type without access to advice. Examples include the following: “If the DOL proposal were to make commission-based accounts unworkable for broker-dealers, these accounts [with balances under \$25,000] could no longer be maintained” (NERA 2015a, p. 12); “Millions of existing small balance IRA owners are likely to lose access to the financial advisor of their choice or any financial advisor at all” (Oliver Wyman 2015, p. 3); “it is very likely that under the current proposal investors with less than \$100,000 in IRA balances would not be able to get access to fee-based accounts” (ICI 2015a, p. A-1); and “Faced with this new [fiduciary] duty for brokerage accounts, many brokerage firms would likely react either by exiting the segment of the IRA market represented by individuals with modestly sized portfolios [...] or by switching to a fee-based advisory model for these investors” (Litan and Singer 2015a, p. 12). The studies vary in their assessment of a balance threshold below which advisory accounts would be unprofitable. ICI (2015a) assumes that the minimum balance for an advisory account is \$100,000; others contend the minimum balance may be as low as \$25,000.

Many factors cast doubt on the studies’ premise that IRA account holders with low balances will lose access to advice.

First, smaller investors already have advisory accounts despite assertions that low-balance advisory accounts are not profitable. The data described by NERA (2015a,

2015b) show that approximately 8% of IRAs with balances under \$25,000 are advisory accounts, and 20% of IRAs under \$100,000 are advisory accounts (compared with 29% across all account sizes).<sup>13</sup> Evidence from overseas similarly suggests that low-balance accounts can be serviced profitably in the absence of conflicts of interest. For example, among Dutch accounts whose advisers “are paid fixed wages only,” Kramer (2012) found that the 5<sup>th</sup> percentile of account balances was just €600.

Second, the Proposed Rule contains carve-outs and exemptions that seek to preserve current business models. Citing unspecified sources or no sources at all, several studies argue that the exemptions are unworkable. However, it is ultimately an empirical question to what extent financial institutions will take advantage of available exemptions.

Third, in addition to the two points above which are enough to demonstrate that smaller investors can and do have advisory accounts, financial institutions may develop new account types, or adjust current-style brokerage and advisory accounts. The perspective that current-style brokerage and advisory accounts, with current-style pricing structures, will be the only options available to IRA investors after conflict-of-interest regulations go into effect is too static. The declining cost of providing advice and related services has already created opportunities for new account types. The marketplace for new advisory options is rapidly changing with the arrival of automated or ‘robo’ investment advice. The minimum balance requirement for many of these robo-advisers is low enough to cater to IRA accounts with assets under \$25,000. For example, Tergesen (2015) documented that many robo-advisory firms, including such well-known investment advisory firms as Wealthfront Inc. and Betterment LLC have minimum balance requirements ranging from \$500 to as low as \$0. By definition, lower-balance accounts have fewer assets to invest and likely require fewer services than larger accounts. This characteristic can make them particularly suitable for automated advice. Also, target date funds rebalance automatically and adjust their exposure to risk automatically, thereby reducing the effort required to maintain an account.

In addition to the existing options, new options are appearing in the marketplace. For example, investors who strongly prefer human-based investment advice may have alternative options. Innovation in the marketplace for investment advice includes the advent of a hybrid model that combines automated and human-based investment advice methods. FutureAdvisor and SigFig, two hybrid online investment management advisers, offer access to an investment adviser to accounts with a minimum balance of \$10,000 (FutureAdvisor 2015, SigFig 2016). Another hybrid investment adviser, Personal Capital, recently lowered its minimum required to open an account from \$100,000 to \$25,000 and is part of an industry trend towards lower minimum balance requirements.

---

<sup>13</sup> NERA (2015b, p. 4) shows that about 9% of fee-based accounts and 41% of commission-based accounts had balances under \$25,000. NERA (2015a, p. 4) states that 29.36% of accounts were fee-based, i.e.,  $9\% \times 29.36\% = 2.6\%$  of accounts were fee-based with a balance under \$25,000 and  $41\% \times (1-29.36\%) = 29.0\%$  were commission-based with a balance under \$25,000. Fee-based accounts thus make up about  $2.6\% / (2.6\% + 29.0\%) = 8\%$  of all accounts with balances under \$25,000. Analogous logic shows that about 20% of accounts with balances under \$100,000 were fee-based. Also see Table 4 on page 40 of this document.

Major brokerage houses that currently offer commission-based IRA accounts are entering the automated advice market and making automated advice a viable alternative to traditional investment advice models. A recent study forecasts that robo-advisory services will manage more than \$2 trillion in assets in just four years from now (AT Kearney 2015).

Fourth, additional evidence from overseas suggests that concerns over the loss of advice failed to materialize because investors who stopped being served found a replacement adviser. In a preliminary evaluation of changes to the financial system in the United Kingdom, which recently banned payments to financial advisers that depend on the advice given, Europe Economics (2014, p. 63) found:

Some advisers have sought to terminate unprofitable client relationships. Data from NMG Consulting, for example, imply that in the year to Q1 2014 about 310,000 clients stopped being served for this reason. On the other hand 820,000 clients were gained in the same period. The same survey indicates that advisers refused to serve about 60,000 (potential new) clients in the same period. If we assume that many of those clients with relationships terminated on the grounds of inadequate profitability sought out another adviser, the positive net increase in customers served suggests that such looking around for a replacement was largely successful. We cannot rule out the existence of a residual group of consumers denied service in this way. However these data do not speak to a significant issue here.

Fifth, the argument that an investor can be served profitably in a brokerage account but not in an advisory account raises the uncomfortable question of how advisers are able to serve small brokerage accounts under the current regime. The cost of providing advice depends not on the adviser's compensation structure but on the adviser's time, IT infrastructure, and other inputs. Suppose an adviser requires, say, \$500 annually to serve a \$20,000 account. If conflicted payments were banned, she could charge an asset-based fee of 2.5% (or a flat \$500) and continue providing financial advice. The account holder may object to such charges as too high and decide to forego the advice. This scenario is consistent with the argument that advisers would be unable to charge fees sufficient to cover their costs. At issue is why the account holder and the adviser have a relationship under the current regime. A plausible explanation is that the account holder does not realize how much he is paying for advice; once confronted with the full cost, he is not willing to buy it anymore. This implies a market failure: brokerage account holders may currently purchase too much conflicted advice. Basic economics suggest that a reduction of advice, resulting from greater transparency of costs and fees, will benefit the account holder.

In short, the financial industry, renowned for its ability to innovate and evolve, is likely to adapt to new regulation. Some providers may adjust their processes and recordkeeping to take advantage of carve-outs and exemptions. Perhaps more importantly, new technology and such products as target date funds are driving down the cost of serving small accounts and allow for modified account types or price structures. That trend is already well on its way.

### ***Common Theme 3: Lack of Advice Will Cause Investors to Make Mistakes and Save Less***

The third common theme is the argument that reduced professional advice will cause IRA investors to make more investment mistakes and save less. The argument tends to be based on research that purports to show benefits of financial advice. For example, ICI (2015a, p. 8): “Research shows that investors with access to advice have more diversified portfolios and take on more appropriate levels of risk than those who do not receive advice or information”; Litan and Singer (2015a, pp. 10-11): “brokers encourage their clients to save [...] and] brokers help reduce investors’ tendency to under-diversify in local stocks by overcoming the home-bias effect”; Quantria (2015, p. 12): “Access to financial advice counters the effects of a lack of financial literacy.”

We agree that many investors benefit from professional advice, such as through increased saving or reduced investment mistakes. However, the benefits likely depend on the type of advice that is given. The studies under review are concerned that investors with small balances in brokerage accounts will lose access to advice. Such advice is subject to conflicts of interest and it is given to investors with relatively few assets. Under those conditions, much of the evidence put forth by the studies under review dissipates.

First, the studies tend to confuse the benefits of conflicted and non-conflicted advice. The studies that are cited as evidence of the benefits of professional advice tend to focus on non-conflicted advice. Each study cites its own body of literature and we will address specific citations in the individual reviews below, but our overall finding is that no study identified benefits of conflicted advice. (This does not imply that conflicted advice yields no benefits; we find only that none of the studies helped identify or quantify such benefits.)

Second, the studies tend to confuse causality with correlation. For example, Oliver Wyman (2015, p. 2) finds that “advised individuals aged 35-54 years making less than \$100K per year had 51% more assets than similar non-advised investors.” It is doubtful that advisers deserve all the credit for the observed difference: did advisers prod their clients to save more, or are individuals who are serious about retirement saving more likely to seek professional advice? The causality may well run both ways. Oliver Wyman (2015) even designed and fielded its own survey but did not document the timing of financial advisers’ involvement or any other questions that could have demarcated their role. Similarly, the literature cited in other studies under review did not distinguish causality from correlation.<sup>14</sup>

Third, the studies focus on gross benefits only, without taking costs into consideration. For example, some studies tout that advised households rebalance their portfolio more often than non-advised households. While that may seem laudable, rebalancing involves selling and buying securities and thus transaction

---

<sup>14</sup> That said, two academic articles (both cited by NERA 2015a) presented evidence indicating that at least some of the increased saving occurred after an adviser was retained. Both related to overseas households and at least one to non-conflicted advice. Also see Section 3.

costs. Without information on brokerage commissions and front-end load fees, the net benefits of frequent rebalancing are questionable.<sup>15</sup>

Fourth, several studies reference DOL's (2011) analysis of expanded investment advice for evidence that advice results in investors' avoiding investment mistakes that would cost them roughly \$7bn-\$18bn. The focus of DOL (2011) is on *non-conflicted* advice. Also, the benefits estimated in that analysis relate to all IRA and DC balances. In contrast, the advice at issue here relates to only IRA balances that are too small to be served in an advisory account. While many IRA accounts are small, most of the dollars (and potential dollars of investment mistakes) are in larger accounts. Households with IRA assets under \$25,000 jointly own only 2% of total IRA assets (Panis and Brien, 2016).

In short, the studies under review cite numerous articles to demonstrate the benefits of advice, but none applies to the conflicted advice that is the focus of the Proposed Rule. We find it plausible that conflicted advice generates certain benefits, but their nature and magnitude remain in question.

### ***Common Theme 4: The Academic Literature Is Misapplied***

The fourth common theme is the argument that the RIA misapplies or misinterprets various academic studies upon which it relies. Examples include the following: "The academic research cited in the RIA is misapplied" (NERA 2015a, p. ii); "The academic studies the RIA cites do not support its sweeping claims" (ICI 2015a, p. 8); and "The RIA misuses these studies, however, and in the process, substantially overstates any benefits claimed from them" (Litan Singer 2015a, p. 22).

We carefully evaluated the commentators' arguments and found them to be lacking. This section discusses some recurring criticisms.

First, several studies argue that the academic studies are inapplicable because they are based on obsolete data. Christoffersen et al. (2013) used data from 1993 to 2009, Bergstresser et al. (2009) is based on data from 1996 to 2004, Del Guercio and Reuter (2014) covered 1992 through 2004, et cetera. The general argument is that load charges on mutual funds have diminished since the early 2000s, that conflicts of interest have faded correspondingly, and the underperformance of broker-sold funds found in the academic literature should no longer be of much concern.

The comments do not consider the fact that econometric relationships can be robust to changes in the levels of explanatory variables. For example, Christoffersen et al. (2013) estimated the relationship between broker payments and rates of return. Diminishing average loads and average broker payments do not affect the estimated relationship; a decline in broker payments would imply only that the underperformance became smaller. Indeed, ICI (2015c, p. 9) replicate Christoffersen et al.'s (2013) calculations with more recent data and find very similar (and even somewhat stronger) results. The average broker payment in the data of Christoffersen et al. (2013) was 2.3%, but the RIA adopted 1.41% for 2015 and assumed that it would continue to decline to 0.78% by 2036 (DOL 2015, p. 113).

---

<sup>15</sup> Vanguard (2014, p. 15) made a similar observation.

Separately, the reduction in loads has not been so precipitous as some suggest. ICI (2015a, p. 9) argued that “in 2000 only about half of the funds with a front-end load share class also had no-load share classes [...]. By 2010, however, 90 percent of funds with a front-end load share class also offered a no-load share class.” However, as also pointed out by Christoffersen and Evans (2015), more important than a simple count of funds with no-load share classes are the dollars in those funds. Load funds accounted for 36% of retail assets in 2014, down from 49% in 2005 (ICI 2015d, Figure 5.10)—a smaller but far from negligible fraction, and still accounting for \$2.6 trillion dollars. Similarly, NERA (2015a, p. 31) claims that “[o]ver the period 1990-2013, front-end sales loads have declined by nearly 75 percent for equity funds and hybrid funds, and even more than that for bond funds.” As noted by ICI (2015d) and cited by NERA (2015a), part of this decline is due to load waivers for DC plan purchases, which are not at issue here. Indeed, DC assets rose nine-fold from 0.7 trillion in 1990 to 6.3 trillion in 2013 (ICI 2006, 2015d), thereby bringing down average load charges. In other words, the NERA claim exaggerates the decline in average load charges among mutual funds in IRAs.

Second, some studies objected to the fact that various academic analyses were not weighted by assets or by sales (except for Bergstresser et al., 2009). Indeed, for some purposes, weighting can be important. The average load charge across all load funds, for example, may be more meaningful when a weighted average is calculated. In econometric models, weights may affect the standard errors (the precision of the estimates). However, if the model is correctly specified, and especially if it controls for fund sales or assets, omitting weights does not introduce any bias in the parameter estimates.

Third, some studies interpreted the findings of Christoffersen et al. (2013) as evidence that funds with above-average broker payments underperformed direct-sold funds, and objected to an extrapolation to all funds with any broker payments. However, this objection rests on a logical error. Christoffersen and co-authors were correct to apply their results to all funds with broker payments, as was the DOL in its RIA. The authors estimated the relationship between broker payments (relative to an average) and rate of return. They found that performance decreases as broker payments increase; above-average broker payments suffer from above-average underperformance, and below-average broker payments suffer from below-average underperformance. Their measurement of broker payments relative to an average has no bearing on the estimated relationship for funds with below-average broker payments. Their estimates implied that funds with below-average broker payments had below-average underperformance, not that they had zero underperformance.

Another way to approach the argument is as follows. Christoffersen et al. (2013) found that funds' rates of return decrease by 0.4972 percentage points for every percentage point increase in broker payments. Logically, funds with zero broker payments are free from a conflict of interest and their underperformance is zero. At a broker payment of 1%, estimated underperformance is  $0.4972 \times 1\% = 0.50\%$ , at 2% it is  $0.4972 \times 2\% = 0.99\%$ , etc. Christoffersen et al. (2013) reported average broker payments of 2.3%, where the estimated underperformance is  $0.4972 \times 2.3\% = 1.14\%$  (reflects rounding error; the authors reported 1.13%). Funds with broker payments in excess of 2.3% underperform by more than 1.13% and funds with broker payments under 2.3% underperform by less than 1.13%; on average, load funds underperform by 1.13%.

Fourth, at least one study argues that the cited literature focuses on mutual funds, yet the DOL applies the results more widely. Indeed, the Proposed Rule applies to, for example, variable annuities that are purchased with IRA assets. Variable annuities offer sizeable sales commissions to brokers and thus present conflicts of interest. If anything, the conflicts of interest presented by annuities appear to be sharper than those of mutual funds. According to an industry expert cited in Scism (2012), commissions on indexed annuities average 6.3% of the principal payment, much higher than even the maximum front end load on most mutual funds.<sup>16</sup>

Fifth, some studies under review assert that the academic literature cited in the RIA is not applicable because it does not compare the costs and benefits of fiduciary accounts with those of brokerage accounts. This perspective is overly narrow and misses the point. The cited literature compares outcomes related to conflicted and non-conflicted compensation. Indeed, this distinction tends to correspond to the distinction between brokerage and fiduciary accounts. However, at issue is the conflicted compensation, not the name or structure of the account.

---

<sup>16</sup> Also see AXA Equitable Life Insurance Company (2013), Jackson National Life Insurance Company (2013), and UBS (2015).

### 3. NERA ECONOMIC CONSULTING

#### *Summary*

In response to DOL's Proposed Rule, SIFMA submitted comments including "Comment on the Department of Labor Proposal and Regulatory Impact Analysis" by NERA Economic Consulting (NERA 2015a). In response to questions from the DOL, NERA provided additional details in a memorandum (NERA 2015b). This section contains a review of the NERA comment and the subsequent memorandum.

The basic premise of the NERA comment is that the Proposed Rule will force brokerage accounts to close, with two consequences: accounts with sufficiently high balances will be moved to a fee-based model, and account holders with small balances will lose access to advice. For the first group, NERA addresses costs of impeding the commission-based investment model. For the second group, it addresses costs of losing access to advice. Finally, NERA challenges the DOL's estimates of the costs of conflicted investment advice.

NERA's analysis of the costs of impeding the commission-based investment model is based on a confidential data set of IRAs which is not publicly available. Hence it is not possible to critically assess some important dimensions of NERA's calculations.

NERA argues that commission-based accounts incur lower fees than fee-based accounts. However, its comparison excludes important fee components. NERA acknowledged the bias but did not do anything to mitigate it even though that would have been relatively straightforward with publicly available information. Separately, and contrary to NERA's claims, NERA's own data suggest that commission-based accounts may have underperformed fee-based accounts on a risk-adjusted basis. In particular, rather than earning virtually the same median return as fee-based accounts, because brokerage accounts in NERA's database may have been riskier, they could have earned *higher* returns, reflecting the risk premium that should have been earned by riskier assets during the period of a strongly appreciating overall market between mid-2012 and early 2015. A particularly troublesome aspect of NERA's analyses is the lack of detail about its data source. NERA (2015a) only presents findings for median accounts. Concerns over conflicted advice are likely to manifest themselves away from the median: commissions may be excessive for a minority of accounts, excessive trading may be found in a minority of accounts, underperformance may be serious for a minority of accounts, etc. Median statistics cannot show any such pattern. In addition, even after being asked directly and given the opportunity to investigate, NERA (2015b) could not provide assurances that the data were representative of financial institutions or IRA accounts in the United States.

NERA next sets out to show that loss of professional advice would be detrimental to investors. We find it plausible that many advisers help reduce investment errors, but the evidence put forth by NERA is not convincing—the mostly foreign studies reviewed may not be applicable to the U.S. context, the studies are selectively quoted or even misquoted, NERA highlights only benefits of advice without weighing those against their costs, and some studies confuse correlation with causality. That said, two studies provided compelling evidence of value added by advisers. One of those articles related to advisers who were relatively free from conflicts of interest,



confirming the value of fiduciary advice but not helping the case for conflicted advice. Separately, NERA misquotes DOL's own analysis of losses due to investment errors. DOL's figures applied to fiduciary advice for all DC plan participants and IRA holders, whereas NERA is concerned with non-fiduciary advice for IRAs with small balances—NERA's assumption that the value of non-fiduciary advice is the same as that of fiduciary advice ignores the very impetus of the Proposed Rule, and even if the two types of advice were equally effective at avoiding investment mistakes, NERA should have reduced the purported benefits by at least 98% to account for the much smaller asset base.

Finally, the NERA comment challenges DOL's calculations of the cost of conflicted advice, asserting that the DOL misapplied or misinterpreted academic studies. Each of its lines of attack however, falls flat due to NERA's own misunderstanding of the literature and of DOL's approach and due to NERA's deficient and narrow interpretation of the applicability of academic studies.

## ***Synopsis***

The basic premise of the NERA comment is that the Proposed Rule will force brokerage accounts to close, with two consequences: accounts with sufficiently high balances will be moved to a fee-based model, and account holders with small balances will lose access to advice. For the first group, NERA addresses costs of impeding the commission-based investment model (Section 1). For the second group, it addresses costs of losing access to advice (Section 2). Finally, NERA challenges the DOL's estimates of the costs of conflicted investment advice (Section 3).

To analyze costs of impeding the commission-based investment model, NERA collected account-level data on over 63,000 fee-based and commission-based IRAs. The authors found that median fees on fee-based accounts were 57-101 bps higher than on commission-based accounts, depending on account balance. They also found that, at the median, fee-based accounts traded more frequently than commission-based accounts. Based on median quarterly rates of return, the authors found that commission-based accounts did not underperform fee-based accounts between mid-2012 and early 2015.

About 40% of commission-based IRA balances were below \$25,000, characterized as the "conservative minimum account balance" (NERA 2015a, p. 9) required to open a fee-based account. NERA assumes that the Proposed Rule will trigger a loss of access to financial advice for these account holders. NERA asserts that loss of professional advice would cost more than the current cost of conflicted advice because individual investors benefit from financial advisers through better diversified portfolios, fewer investment mistakes, tax minimization, increased savings, and lower cost of information. NERA then reviews a 2011 analysis by the SEC into potential consequences of imposing fiduciary duty on brokers and a 2011 analysis by the DOL, which estimated that more advice to DC plan participants and IRA holders could prevent mistakes that would cost investors \$7 billion to \$18 billion annually.

The third section concerns the cost of conflicted investment advice. Referring to estimates of the cost of conflicted advice in the Proposed Rule's RIA, NERA concludes that the "range of numbers is so wide as to provide no scientific confidence in the DOL's own methodology" (NERA 2015a, p. 30). It then argues that the RIA misapplied findings of the academic literature on the cost of conflicted advice: the

literature focuses on mutual funds, but the RIA applies it also to variable annuities and other products; the RIA takes results associated with higher-than-average load funds and misapplies them to all funds; and the literature does not compare the costs and benefits of fiduciary accounts with those of brokerage accounts.

## ***Discussion***

### **Overview**

Throughout its comment, NERA discusses and compares fee-based account and commission-based accounts. “Fee-based accounts are charged a fixed fee as a percentage of assets whereas commission-based accounts are charged fees based on trading and other activity” (NERA 2015a, p. 3). In related literature, fee-based and commission-based accounts are also referred to as advisory and brokerage accounts, respectively. Advisers to fee-based advisory accounts are generally held to a fiduciary standard of conduct, whereas advisers to commission-based brokerage accounts are held to a lower suitability standard. The Proposed Rule is concerned that advisers to commission-based accounts face conflicts of interest.

The remainder of this section follows the organization of the NERA comment. We first discuss NERA’s Section I on the costs of impeding the commission-based investment model, then Section II on costs of losing access to advice, and finally Section III on the costs of conflicted advice.

### **I. Costs of Impeding the Commission-Based Investment Model**

As summarized above, this section compares commission-based and fee-based IRA accounts with respect to fees and rates of return. NERA’s analysis is primarily based on a confidential dataset of over 63,000 IRA accounts with data ranging from 2012 through the first quarter of 2015.

The NERA comment purports to show that fee-based accounts are more expensive than commission-based accounts. The magnitude of the difference ranges from “about 57 basis points (bps) for relatively small accounts (those with balances below \$25,000) up to about 1 percent for accounts with balances from \$100,000 to \$250,000” (NERA 2015a, p. 6). But fees in this comparison “exclude revenue that the firm may receive indirectly from the account-holder, such as markup/markdown revenue or 12b-1 fees” (NERA 2015a, p. 4). These and other indirect revenue components vary across products, tend to constitute conflicted compensation, and their exclusion therefore makes brokerage accounts appear less expensive than they really are. In the absence of these fees, it cannot be determined whether fee-based accounts are more or less expensive than commission-based accounts. For example, 12b-1 fees and shareholder service fees can run as high as 100 bps (SEC 2015); at that level, fee-based accounts would incur lower fees than commission-based accounts.

The NERA comment recognizes this deficiency in a footnote and seeks to address it in its comparison of rates of return, but not in its fee comparison.

The NERA memorandum defended the exclusion of indirect fees with the assertion that its data set did not contain information related to such fees. However, the detailed, account-level data that NERA compiled presumably included information on portfolio compositions, and 12b-1 fees for individual funds are readily available from

Morningstar and other sources. In other words, NERA's fee comparison is biased; NERA acknowledged the bias and did not do anything to mitigate it even though doing so would have been relatively straightforward with publicly available information.

NERA's Section 1 continues with the argument that individuals self-select into the account type that favors their behavior, based on more frequent trades in fee-based accounts than in commission-based accounts. But the comment fails to qualify what kind of trade transactions have been included and excluded from this comparison. For example, it is not clear whether fee payments for account maintenance and advisory services are included. For fee-based accounts, these fees are expected to be small and periodic and could skew the results. By contrast, commission-based accounts which have few direct fees assessed may not have such trades. Also, many trades may be related to purchases, (mandatory) distributions and dividend reinvestments.<sup>17</sup> The NERA comment does not specify either whether these trades are removed from this analysis.

More generally, NERA provided very little explanation of its data source, which raises questions about the completeness and robustness of its findings. The analysis purports to compare commission-based and fee-based accounts, but the age distribution (Exhibit 1) and the account balance distribution (Table 1) are reported across all account holders. Further, the comparisons of account fees and trading frequency are carried out entirely on the basis of median values, which may not reflect relevant information on 63,000 IRAs. For example, NERA notes that "it is worth noting that the data does not seem to show 'churning,' the needless buying and selling of securities. We see the median commission-based account had traded 6 times in 2014. Such trading is more consistent with a buy-and-hold strategy than churning" (NERA 2015a, p. 8). We agree that the median number of trades does not reflect churning. However, the presented figures are also consistent with abundant churning among 49% of commission-based accounts. Insofar we are aware, nobody is alleging that conflicts of interest cause advisers to churn almost one-half of commission-based accounts, but the DOL would presumably be concerned if it occurred in 5% of the accounts. To that end, the 95<sup>th</sup> percentile of number of trades would be informative. Based solely on the median, NERA's conclusion that churning is not an issue is unconvincing.

NERA presented even fewer relevant details in its comparisons of rates of return for fee-based and commission-based accounts. This part of the analysis is highly relevant, because much of the concern over conflicts of interest is driven by underperformance of funds sold in commission-based accounts. This underperformance has been documented based on publicly available data in peer-reviewed academic articles (e.g., Bergstresser et al., 2009; Christoffersen et al., 2013; Del Guercio and Reuter, 2014). NERA claims to have found that rates of return in commission-based accounts are in fact about equal to those in fee-based accounts. For this claim—based on confidential data and without peer review—to be credible, the analysis needs to be extensively documented and stress-tested. Instead, NERA devotes merely one page to the analysis description and presents

---

<sup>17</sup> The NERA memorandum showed that individuals age 60 and older are more prevalent among fee-based account holders than among commission-based account holders. These individuals may take regular distributions to fund their retirement, and may even be forced to take distributions because of minimum distribution requirements that apply above age 70½.

quarterly differences in median returns only (NERA 2015a, Table 4, p. 10), with no controls for such factors as the riskiness of investments that are prominent in the academic literature. Even the quarterly returns remain unreported; only the differences in median returns between fee-based and commission-based accounts are provided.

In response to questions from the DOL, the NERA memorandum provides some more, though still inadequate, details.

The analysis of rates of return falls short in several aspects.

First, the comment fails to adjust for differences in riskiness (volatility) of account portfolios. This is important if assets in fee-based and commission-based accounts differ in the average level of risks. For example, a portfolio invested only in stocks that make up the S&P 500 index would have realized compound annual growth rate of approximately 19% over the period of the study, much higher than the historical average rate of return on stocks (finance.yahoo.com, SP500TR). But of course investing in stocks only will not be suitable for all investors, particularly not for those nearing retirement. The NERA memorandum (NERA 2015b, p. 4) shows that account holders of fee-based accounts tend to be older than commission-based account holders. Roughly 58% of fee-based account holders are age 60 or older, compared with roughly 48% of commission-based account holders. Based on their higher ages, fee-based account holders probably invest in less risky assets than commission-based account holders.

The NERA memorandum suggests that commission-based accounts are invested in riskier assets than fee-based accounts. Table 1 below transcribes the 25<sup>th</sup> and 75<sup>th</sup> percentiles of quarterly rates of return for fee-based and commission-based accounts in the NERA sample, as provided in the NERA memorandum (NERA 2015b, p. 3). We calculated the interquartile range—the difference between the 75<sup>th</sup> and 25<sup>th</sup> percentiles—for each quarter. The interquartile range is a measure of the dispersion of rates of return, which may be related to the riskiness of invested assets in the individual accounts. In 10 of the 11 quarters of data, the interquartile range for commission-based accounts exceeded that of assets in fee-based accounts.

**Table 1. Percentiles and Interquartile Range of Quarterly Rates of Return of Fee-Based and Commission-Based Accounts in the NERA Sample**

Quarter	Fee-based accounts			Commission-based accounts		
	25th percentile	75th percentile	Interquartile range	25th percentile	75th percentile	Interquartile range
Jun-12-Sep-12	3.16%	5.45%	2.29%	2.58%	5.76%	3.18%
Sep-12-Dec-12	-1.16%	1.79%	2.95%	-0.93%	1.58%	2.51%
Dec-12-Mar-13	3.27%	7.81%	4.54%	3.44%	9.71%	6.27%
Mar-13-Jun-13	-1.76%	0.95%	2.71%	-0.90%	2.27%	3.17%
Jun-13-Sep-13	3.29%	6.44%	3.15%	1.45%	6.41%	4.96%
Sep-13-Dec-13	3.81%	7.14%	3.33%	2.51%	8.24%	5.73%
Dec-13-Mar-14	0.41%	1.77%	1.36%	0.26%	2.55%	2.29%
Mar-14-Jun-14	2.58%	4.17%	1.59%	2.01%	4.66%	2.65%
Jun-14-Sep-14	-2.52%	-0.80%	1.72%	-1.85%	0.18%	2.03%
Sep-14-Dec-14	0.19%	2.54%	2.35%	-0.11%	3.17%	3.28%
Dec-14-Mar-15	0.74%	2.53%	1.79%	0.00%	2.69%	2.69%

Source: NERA (2015b), p. 3.

In a bull market (such as the period studied by NERA), the rates of return on riskier assets may be expected to be higher, suggesting that commission-based accounts should have returned a premium over less risky assets in fee-based accounts. NERA (2015a) did not control for volatility or find such a premium. The limited information that NERA made available does not permit quantifying the risk premium that commission-based accounts should have earned, but it may explain why NERA did not find underperformance. Without exploring the issue, NERA (2015a, p. 11) had insufficient basis to conclude that “there is no support in this data for the contention that commission-based accounts underperform.”

Second, the NERA comment based its underperformance analysis entirely on median quarterly rates of return. At best, such data support a conclusion about underperformance at the median; they do not support any conclusion about accounts above or below the median. For example, the median would be the same if 49% of commission-based accounts performed extremely poorly. Again, insofar we are aware, nobody is alleging that conflicts of interest cause advisers to place almost one-half of commission-based accounts in grossly underperforming funds, but the DOL would presumably be concerned if it occurred in 5% of the accounts. To that end, the 5th percentile of rates of return would be informative. Based solely on the median, NERA’s conclusion that underperformance is not an issue is unconvincing.

The NERA sample raises many more questions. For example, some IRAs presumably included variable annuities; how were those treated in the analysis? Separately, there is no discussion of sampling weights or of any attempt to ensure representativeness of the sample. NERA’s response to DOL questions about representativeness of the sample and generalizability of the analysis findings was only that the “the sample accounts contained a wide variety of balances, transaction activity levels, and customer ages” (NERA 2015b, p. 1) and that the authors had “confidence that our data included a diverse selection of accounts, with no evidence of any bias in the data” (NERA, 2015b, p. 2). Of course it is impossible to detect a bias without conducting a comparative analysis of the IRA population.<sup>18</sup> The validity of using a particular sample to reflect the characteristics of a population can be determined by describing the sampling process exactly and in some cases by assessing the characteristics of the sample compared to the population of interest. NERA provided none of this standard information. NERA did not even describe the firms at which the accounts were held, other than that they are SIFMA members.

Finally, NERA’s Section 1 was motivated by the assertion—without evidence or even arguments—that the Proposed Rule and associated RIA “have led many to conclude that the proposal would effectively make the commission-based brokerage model

---

<sup>18</sup> For example, NERA (2015a, p. 5) reported an average IRA balance in its sample of \$174,034. In contrast, Panis and Brien (2016, p. 39) documented an average balance of \$100,998 in the nationally representative Survey of Consumer Finances (assets of \$6.676 trillion divided by 66.1 million accounts). Similarly, Copeland (2015, p. 7) documented an average IRA account balance of \$95,363 for 2013. The latter sources include small accounts, whereas NERA (2015a) reportedly excluded accounts under \$1,000. However, for the NERA average to be consistent with the national average, at least 42% of accounts must have been under \$1,000. According to ICI, only 22% of traditional IRAs (ICI 2015e) and 24% of Roth IRAs (ICI 2015f) had balances under \$5,000 in 2013. In other words, NERA’s sample is biased toward larger accounts.

unworkable for investment accounts covered by ERISA and similar sections of the IRS code” (NERA 2015a, p. 2). NERA proceeds to assert that commission-based “investors will have to move to fee-based accounts or lose access to professional investment advice entirely” (NERA 2015a, p. 9). As discussed in Section 2 (Common Themes), the comment ignores the possibility that financial institutions will modify their commission-based account types or introduce types other than current-style commission-based or fee-based accounts.

## II. Cost of Losing Access to Advice

The second section of the NERA comment focuses on the cost of losing advice. This issue may become relevant if future regulation prompts financial institutions to discontinue certain IRAs. NERA asserts—without evidence—that IRAs with a balance of less than \$25,000 may no longer receive advice. Based on its proprietary dataset of IRA accounts, NERA (2015a) projects that 40% of commission-based accounts will lose access to a financial adviser. NERA’s database is reportedly drawn from SIFMA members, which include discount brokerages. To the extent the IRA accounts include discount brokerage accounts, the fraction of accounts that will lose access to advice is in fact lower.

The assertion that the commission-based brokerage model will become unworkable is questionable and has been addressed in the Section 2 of this report (Common Theme 2).

We first narrow down the area of interest. The Proposed Rule aims to mitigate conflicted advice. For the purpose of quantifying the cost of losing access to advice due to the Proposed Rule, the focus should therefore be on benefits of conflicted advice only. It is not relevant or logical to discuss the benefits of fiduciary advice, because it will not be reduced or restricted by the Proposed Rule.

NERA’s comment references a 2011 DOL analysis of losses due to investment errors to suggest that DOL itself attributed huge value to professional advice.<sup>19</sup> NERA states that “the DOL estimated that participant-directed retirement savings account holders make investment mistakes *in the absence of professional advice* valued at an aggregate of ` more than \$114 billion in 2010” (NERA 2015a, pp. 11-12; emphasis added). However, NERA misinterprets and misapplies DOL’s earlier analysis. The wording suggests that professional advice could prevent \$114 billion in losses, but the DOL in fact estimated that increased access to advice would reduce these losses by \$7 billion to \$18 billion. Further, those estimates related to assets in all DC plans and IRAs, rather than just IRAs with balances under \$25,000, which account for less than 2% of total DC plan and IRA assets (Panis and Brien 2016). Finally, the estimated reduction of investment errors would be the result of increased access to fiduciary advice, not conflicted advice.

NERA cites a number of studies that found that many individual investors make suboptimal investment decisions: they may be more inclined to lock in gains than to cut losses, and they may trade too often and incur excess transaction costs. The authors then discuss a number of articles that they claim demonstrate that financial advisers help reduce investment errors. While we find it plausible that many advisers help reduce investment errors, the evidence put forth by NERA is not convincing—the mostly foreign studies may not be applicable to the U.S. context, the studies are

---

<sup>19</sup> See Federal Register, Volume 76, pages 66136-66167 for the 2011 DOL analysis.

selectively quoted or even misquoted, NERA highlights only benefits of advice without weighing those against their costs, and some studies confuse correlation with causality.

First, consider applicability of the cited studies. The NERA comment's section on "Benefits of Financial Advisors" (NERA 2015a, pp. 17-22) discusses 17 papers. Eleven papers are based on foreign data (Germany, Canada, Netherlands, United Kingdom, Israel, and Australia), two were theoretical exercises without empirical data, and only four were based on U.S. data. Legal and regulatory regimes vary by country; therefore, the foreign studies are relevant only to the extent that foreign advisers are subject to conflicts of interest. For example, Bluethgen, Gintschel, Hackethal and Mueller (2008) state that "If retail financial advisory services differ across countries in terms of cost and quality then their effects on household portfolios might also be very different" and go on to suggest that "Regulation aiming to enhance investor protection should then not only focus on capital markets themselves but also set and enforce minimum quality standards for financial advisory services," something the DOL proposal seeks to achieve. However, NERA offers no discussion of foreign advisers' conflicts of interest, if any, and it offers no discussion of the standards—fiduciary, suitable, or otherwise—to which foreign advisers are held. Even for the U.S.-based studies, it is unclear whether the advice under analysis was conflicted.

Second, NERA selectively quotes from the papers it reviews and omits essential findings that counterbalance claims of adviser value. For example, NERA (2015a, p. 17) quotes Gerhardt and Hackethal (2009) as finding "that there are clearly positive effects to working with an advisor." However, the primary conclusion of Gerhardt and Hackethal (2009, p. 22) was that "major aspects of the (positive) effects that have been attributed to the influence of professional investment advisors is in fact due to differences in investors' behavior. The actual effect of investment advisors is – while clearly existing – much smaller than assumed by previous studies." In another example, based on Montmarquette and Viennot-Briot (2012), The Investment Funds Institute of Canada (2012) is quoted as noting "that research proves that advice has a positive and significant impact on wealth accumulation" (NERA 2015a, p. 18). However, the paper does not compare rates of return earned by advised and non-advised investors. The only "highly plausible explanation" offered for observed differences in wealth is that advised households save more than non-advised households, and advisers may not deserve full credit for that relationship (see below).<sup>20</sup> In a third example, Kramer (2012) is summarized as finding that "advised portfolios are more diversified and perform better than self-directed portfolios" (NERA 2015a, p. 18). However, Kramer (2012, p. 395) in fact found "no evidence of differences in risk-adjusted performance." In a fourth example, "Kinniry, Jaconetti, DiJoseph and Zilbering (2014), argue that [...] advisors can potentially add about 3 percent in net returns to investors" (NERA 2015a, p. 18). The key term here is "potentially": this paper, which NERA characterizes as "widely-cited," is marketing and training material for advisory services of a large financial service provider. It describes "best practices" (which almost by definition not all conflicted advisors employ) and offers primarily examples, rather than empirical evidence for its estimates of behavioral biases.

---

<sup>20</sup> NERA does cite that finding on page 20, but incorrectly added that Montmarquette and Viennot-Briot also pointed at improved asset selection as a highly plausible explanation. In fact, Montmarquette and Viennot-Briot attributed only increased savings to the presence of advice.

Third, with worthy exceptions noted below, most of the studies reviewed by NERA fail to weigh the benefits of advice against their costs or gloss over causality issues. For example, several studies found that advised portfolios were better diversified than non-advised ones. We agree that, all else equal, a well-diversified portfolio is generally preferable over a highly concentrated portfolio. However, the advice and the diversification are not free of charge, and a central issue is whether the diversification as advised by financial advisers generated long-term benefits. Despite NERA's repeated claims that advisers help investors make better investment decisions, there is no evidence that advised portfolios outperform non-advised portfolios. Separately, several studies showed that advised households save more than non-advised households. However, it is doubtful that advisers deserve all the credit for observed differences: did advisers prod their clients to save more, or are individuals who are serious about retirement saving more likely to seek professional advice? The causality may well run both ways.

There are two noteworthy exceptions to the causality defects of many studies that purport to measure the value of advisers. The first is Montmarquette and Viennot-Briot (2012), also published as Montmarquette and Viennot-Briot (2015). The authors used Canadian data with information on whether respondents used a financial adviser and the "tenure" of advice, i.e., how long they had been consulting an adviser. The information on adviser tenure reduces some causality issues. For example, while many studies have documented that advised households tend to be wealthier than non-advised households, the authors found that the wealth disparity increased with the duration over which they had been advised. It is still possible that people who are serious about preparing for retirement are more likely to consult an adviser, but Montmarquette and Viennot-Briot (2015) provide convincing evidence that advisers add value by helping people save more.

The other exception is Kramer (2012), who used Dutch data with information both before and after investors started consulting an adviser. He found that portfolios became better diversified after "advisory intervention." Despite better investment behavior, he did not find statistically significant differences in rates of return between advised and non-advised accounts. The financial advisers in his "sample are paid fixed wages only, so they have no direct personal financial incentive to generate commissions, but career and prestige considerations are likely to play a role," suggesting that the value they added was in an environment that was relatively free of conflicts of interest. He also noted that the 5<sup>th</sup> percentile of the advised portfolio value distribution was €600, suggesting that relatively conflict-free advice can be available even at low account balances.

### **III. The Cost of Conflicted Investment Advice**

The last section of the NERA comment focuses on estimates of harm caused by conflicted advice put forth in the DOL's RIA.

The NERA authors take issue with the fact that the RIA presents many different estimates. However, they fail to recognize that the RIA, given the uncertainty embedded within many of the assumptions, has adopted a scenario-based analysis to present both conservative and likely estimates of the harm caused by conflicted advice. This is considered a best practice when uncertainty in assumptions is involved and is widely used when forecasting into the future (e.g., International Actuarial Association, 2013; Maack 2001). Also in light of its sensitivity analyses and



its extensive discussion of uncertainty, the 243-page RIA demonstrates a thoroughness that is commendable.

The NERA comment also asserts that the RIA misapplies the academic literature. These assertions have been addressed in Section 2. In particular, the NERA review finds that “The academic literature cited in the RIA does not compare the costs and benefits of fiduciary accounts with those of brokerage accounts” (NERA 2015a, p. 33). Indeed, such data have not been available, at least not to date and not publicly. NERA appears to have access to IRA data that permit a comparison of fiduciary and brokerage accounts. Our reading of very crude summary statistics of those data indicate that brokerage accounts likely underperformed fiduciary accounts on a risk-adjusted basis—see the discussion above. That aside, the academic literature has centered on underperformance due to conflicts of interest, which is precisely the target of DOL’s Conflict of Interest Proposed Rule. Finally, NERA incorrectly states that DOL has misapplied Christoffersen et al.’s results:

In particular, their study finds evidence that a subset of funds, those whose front-end loads are higher than other funds with similar characteristics, underperformed the average return of their fund category during the next year. In formulating much of their “cost of conflicted advice” aggregate figures, the DOL then assumes that *all* IRAs invested in front-end load funds suffer the same underperformance, thereby mistakenly applying a result from a subset of load funds to all load funds.

The extrapolation the DOL made is analogous to the following: Suppose we conduct medical research and find that people who consume more salt than average have a lower life expectancy by five years, and we then conclude that eating no salt will increase the life expectancy of everyone by five years. This is a logical fallacy. We have no evidence that people who eat a “normal” amount of salt would benefit from reduced salt intake, and so extrapolating to them is an error in logic. (NERA 2015a, pp. 32-33.)

NERA’s analogy does not describe how DOL has applied Christoffersen et al.’s relationship, which indicates that a reduction in front-end loads increases returns, regardless of whether the load is above or below average. In the terms of NERA’s analogy, people who eat a “normal” (or even less than normal) amount of salt would in fact benefit from reduced salt intake.

## 4. OLIVER WYMAN

### *Summary*

In response to DOL's Proposed Rule, several financial firms submitted a report titled "The role of financial advisors in the U.S. retirement market" (Oliver Wyman, 2015). This section contains a review of the Oliver Wyman study.

The Oliver Wyman study establishes that financial advisers tend to be involved when events occur or circumstances exist that are good for retirement security: small businesses sponsor employee retirement plans, individual investors are wealthier, individual investors' portfolios are more diversified, et cetera. In a major shortcoming, the study credits financial advisers for progress toward retirement security in which they were not involved. Attributing all observed differences between advised and non-advised businesses or individuals to financial advisers is clearly an overstatement; small businesses may have retained an adviser after deciding to set up a retirement plan, investors may have retained an adviser after accumulating substantial assets, et cetera. Quite plausibly, causality runs in both directions: some advisers foster retirement security, and some advisers get involved with businesses or individuals who have already made progress toward retirement security. The latter advisers may still add value, but did not play a role in what occurred before their involvement.

Oliver Wyman designed its own surveys of small businesses and individual investors, but missed an opportunity to document the contributions of financial advisers as opposed to progress toward retirement security without the involvement of advisers. The study does not report on the timing of financial advisers' involvement or any other questions that could have demarcated their role. Further, the study does not distinguish between broker-provided and fee-based advice, instead treating them the same and failing to acknowledge that the Proposed Rule targets conflicted advice only.

In another major shortcoming, the study does not address the costs of financial advice to small businesses or individual investors. For example, the study shows that advised individuals rebalance their portfolios more often than non-advised individuals. While that may seem laudable, rebalancing involves selling and buying securities and thus transaction costs. Without information on brokerage commissions and front-end load fees, the *net* benefits of frequent rebalancing—precisely the type of issue that the Proposed Rule aims to address—cannot be determined.

Based on unspecified other sources, the Oliver Wyman study contends that the Proposed Rule will likely limit the ability of financial advisers to offer services to small businesses and individual investors, and raise the cost of such services. The study fails to establish to what extent financial advisers deserve credit for favorable outcomes, fails to examine whether costs outweigh purported benefits of financial advice, and fails to consider whether alternative advisory mechanisms could emerge to serve affected investors.

## ***Synopsis***

The Oliver Wyman study evaluates the role of financial advisers in two areas: advising companies on how to set up DC plans and advising individuals on retirement saving. The first part is based on a survey, conducted by Oliver Wyman, of about 1,200 small businesses. The second part is based on another survey, also conducted by Oliver Wyman, of about 4,400 retail investors and also on data from a third party, IXI Services, on consumer investments. We understand those investments data to be aggregated, i.e., without account-level details.

The first part of the study found that financial advisers assist business owners with setting up a DC plan for their employees. “Specifically, businesses with 1–9 employees with a financial advisor are almost twice as likely to set up a retirement plan as are businesses without financial advisors (51% vs. 26%). Businesses with 10–49 employees with a financial advisor are 48% more likely (77% vs. 52%) and businesses between 50 and 100 employees are 19% more likely (89% vs. 75%) to set up a plan” (Oliver Wyman 2015, p. 14). The study asserts that the Proposed Rule would force financial advisers to stop providing retirement plan services to small businesses; “many small businesses are likely to close or not open plans due to the additional administrative burden as a result” (Oliver Wyman 2015, p. 38).

The second part of the Oliver Wyman study found that investors with a financial adviser had more financial assets and exhibited better investment behavior along several dimensions than investors without a financial adviser. The study asserts that the Proposed Rule would reduce access to financial advisers by retail investors, who would face higher expenses to maintain access to advisers or, deprived of advice, would save less for retirement and would invest less wisely.

In summary, the Oliver Wyman study concludes that the DOL’s Proposed Rule would likely reduce retirement savings.

## ***Discussion***

### **Overview**

The Oliver Wyman study attempts to relate the message that financial advisers make good things happen: small businesses set up DC plans, and individual investors accumulate retirement assets and invest wisely. But the study’s approach and its findings do not support that message. The study demonstrates a correlation between the involvement of advisers and favorable retirement security outcomes, but it does not demonstrate a causal link. Did small businesses set up DC plans because financial advisers convinced them to do so, or did small businesses decide to set up a DC plan before retaining a financial adviser? Did investors accumulate substantial wealth because financial advisers prodded them to save more and invest wisely, or did investors decide to seek professional advice after accumulating substantial wealth? In addition, the study does not discuss how advisers are compensated, i.e., does not identify the contributions of conflicted advice. The study is based on Oliver Wyman’s own surveys of small businesses and retail investors. Either Oliver Wyman missed an opportunity to directly ask about compensation, causality, and timing, or the surveys—which to our knowledge are not publicly released—yielded relevant insights which the study’s authors did not describe.

In its discussion of the report's implications, the authors assert that the Proposed Rule would likely reduce access to financial advisers by small businesses and retirement investors.<sup>21</sup> The authors argue that as a result, "The benefits financial advisers provide are now at risk" (Oliver Wyman 2015, p. 37). However, since the study did not establish to what extent financial adviser involvement *causes* favorable outcomes or to what extent the purported benefits related to conflicted advice, it is not clear what those benefits are.

A second issue relates to costs. Suppose the Proposed Rule would limit access to financial advisers, as the Oliver Wyman study asserts. While the Oliver Wyman study did not distinguish correlation from causality, it seems entirely plausible that the services of financial advisers bring certain benefits. Directly or indirectly, today's advisee pays for the services of financial advisers. Fewer services thus imply both a loss of benefits and a reduction of costs. The Oliver Wyman study highlights the loss of benefits, but does not discuss costs. In a complete evaluation, the loss of benefits would be weighed against lower costs for advisees.

A third issue concerns the static view of the world that the Oliver Wyman study adopts. Suppose, as asserted, that financial advisers would cease to advise certain clients. In the Oliver Wyman view, these clients would face undesirable consequences: "many small businesses are likely to close or not open plans" (Oliver Wyman 2015, p. 38), "Individuals are less likely to open an IRA, leading to lower savings rates and increased cash-outs when changing jobs" (Oliver Wyman 2015, p. 39), and "Unadvised individuals are likely to carry excess portfolio risk due to less diversification and less frequent re-balancing compared with advised individuals" (Oliver Wyman 2015, p. 39). The study ignores the possibility that the abandoned clients would find another financial adviser. For example, in a preliminary evaluation of changes to the financial system in the United Kingdom, which recently banned payments to financial advisers that depend on the advice given, Europe Economics (2014, p. 63) found:

Some advisers have sought to terminate unprofitable client relationships. Data from NMG Consulting, for example, imply that in the year to Q1 2014 about 310,000 clients stopped being served for this reason. On the other hand 820,000 clients were gained in the same period. The same survey indicates that advisers refused to serve about 60,000 (potential new) clients in the same period. If we assume that many of those clients with relationships terminated on the grounds of inadequate profitability sought out another adviser, the positive net increase in customers served suggests that such

---

<sup>21</sup> The study itself does not provide evidence that access to financial advisers would be reduced. Instead, the study relies on unspecified other sources. For example (Oliver Wyman 2015, pp. 2-3):

"Many stakeholders are now analyzing the technical details of the newly proposed rule, and there is growing concern that the proposal would again result in unintended consequences, including limiting the ability of financial services firms and individual financial advisers to offer services to individual IRA holders and small businesses, as well as increasing investor costs due to new expenses associated with implementing the rule and transitioning many clients to a higher cost advisory model."

looking around for a replacement was largely successful. We cannot rule out the existence of a residual group of consumers denied service in this way. However these data do not speak to a significant issue here.

In other words, the industry adjusted to the payments ban and some adviser-client relationships were reshuffled. The initial U.K. experiences suggest that the Proposed Rule would not deprive many retail investors of financial advice.

Similarly, the Oliver Wyman study argues that the Proposed Rule would make it difficult for financial services firms to offer brokerage accounts and would migrate accounts to more expensive advisory accounts. “Almost all retail investors would face increased costs (73% to 196% on average) from providers shifting clients to a fee-based advisory model”<sup>22</sup> (Oliver Wyman 2015, pp. 7 and 38). Again, this view is overly static, apparently grounded in the premise that all accounts, after regulatory changes, will continue to be either traditional brokerage accounts or traditional advisory accounts, with traditional fee structures and traditional product offerings. The fee comparison fails to capture all differences between brokerage accounts and advisory accounts, as demonstrated by the fact that some investors opt for an advisory account today, with its reportedly higher fees. The financial services industry may well adapt and make changes to brokerage accounts or develop an alternative account type. The account fees will presumably be more transparent than they are in today’s brokerage accounts and some clients may be unpleasantly surprised at the expense, but they will be no worse off than in their current brokerage account. If anything, retirement investors will be in a better position to manage their expenses.

Please refer to Section 2 for additional discussion of common themes that apply to the Oliver Wyman study.

The remainder of this section discusses Parts I and II of the Oliver Wyman study, related to small businesses and retail investors, respectively, followed by a discussion of issues with the data sources of the study.

## **I. Role of Financial Advisors in the Defined Contribution Plan Market**

Part I of the Oliver Wyman study starts with statistics on the large and increasing role of DC plans for retirement financing and demonstrates that smaller firms are less likely to sponsor a pension plan than larger firms. These patterns are widely known and not controversial.

The study continues with results from the Oliver Wyman Small Business Survey 2014, a survey of owners and human resources (HR) decision makers at payroll-

---

<sup>22</sup> The increased costs figures are based on Oliver Wyman (2011). They reportedly exclude “marketing and distribution, shareholder services, and other fees not directly paid by investors” (Oliver Wyman 2011, p. 22). The exclusion of marketing and distribution fees is puzzling and skews the results. For example, front-end load fees are disproportionately present in brokerage accounts. Indeed, Oliver Wyman’s increased cost figures seem counter intuitive as they suggest that the largest accounts would incur the greatest cost increases—both in dollars and percentage terms.

based businesses with between 1 and 100 employees. As noted in the study, the survey had a sample size of 1,216 valid complete responses.

A key finding of the Oliver Wyman study comes from a comparison of retirement plan sponsorship among small businesses that did or did not consult with a financial adviser: “We found that 41% of small businesses with 100 or fewer employees work with a financial advisor, and that these firms are significantly more likely to set up a retirement plan. Specifically, businesses with 1–9 employees with a financial advisor are almost twice as likely to set up a retirement plan as are businesses without financial advisors (51% vs. 26%). Businesses with 10–49 employees with a financial advisor are 48% more likely (77% vs. 52%) and businesses between 50 and 100 employees are 19% more likely (89% vs. 75%) to set up a plan” (Oliver Wyman 2015, p. 14).

Oliver Wyman’s key finding may be misleading for several reasons. First, the study speaks of advised small businesses being more likely to “set up” a retirement plan and shows “plan formation rates” (Oliver Wyman 2015, p. 14). This phrasing suggests starting or initializing a plan once an adviser becomes involved. However, the survey appears to record whether businesses *sponsor* a plan, without regard of how long the plan has been in place. Indeed, nothing is reported on the age of the plan or whether an adviser was involved when the plan was set up.

Second, the survey asked respondents “to select all of the advisors that they consult in the management of their business” (Oliver Wyman 2015, p. 12). Given the focus of the study, of course advisers are relevant only if they were involved with the company’s retirement plan. However, the study did not restrict advisers to those who provided assistance with a retirement plan. For example, a firm may have hired a financial adviser solely to assist with succession issues or asset management, but the study would credit this adviser with setting up the firm’s retirement plan.

Third, consider two phases of retirement plan formation: the decision to set up a plan and the process of setting it up. Financial advisers may or may not play a role in either phase. In some cases, financial advisers may have convinced small businesses to set up a retirement plan; in other cases, the small business may have decided to set up a retirement plan and consulted a financial adviser to guide it through the process. Given the study’s focus on the role of investment advisers, it would make sense to include detailed questions in the survey about that role and about the timing of the adviser’s involvement.<sup>23</sup> Unfortunately, Oliver Wyman’s own survey did not include such questions (or the authors chose to not discuss them).

The description of the survey method states that the survey had a stratified design, and “[t]his design allowed us to isolate the impact that financial advisors have upon small businesses” (Oliver Wyman 2015, p. 40). This statement is incorrect; insofar as reported, the survey does not permit any conclusions about the causal effects of advisers on retirement plan sponsorship, and it is especially lacking with respect to the role of advisers who assisted with setting up retirement plans and who were compensated in a conflicted manner.

The Oliver Wyman study also fails to consider that the involvement of a financial adviser may be correlated with other factors that affect the rate of plan formation

---

<sup>23</sup> Insofar we are aware, neither the questionnaire nor the survey’s microdata have been made available.

among small businesses. For example, Brady and Bogdan (2014) found that workforce composition appears to be a primary cause for the lower rate at which small employers sponsor retirement plans. Employees who work for firms that do not sponsor retirement plans are more likely to be younger, have lower earnings, and have less attachment to the workforce—all characteristics associated with being less focused on saving for retirement. By the same token, companies with such employees may be less likely to spend money on financial advisers than, say, high-tech start-ups with a highly educated workforce.

The Oliver Wyman study does not provide clear indications of the extent to which financial advisers deserve credit for companies' decisions to form a plan or the extent to which financial advisers helped guide small businesses through the formation process, especially since a non-trivial fraction of small businesses sponsor a plan without involvement of a financial adviser (46%; see Oliver Wyman 2015, p. 14). It appears plausible that financial advisers played a role in the formation of a number of retirement plans, but the Oliver Wyman study does not support any quantification.

## **II. Role of Financial Advisors in Helping Individuals Save for Retirement**

The second part of the Oliver Wyman study focuses on the role of financial advisers in helping individual investors. Some of it applies to DC plan investments, some to IRA investments, and some to after-tax accounts. The analysis is based on the Oliver Wyman Retail Investor Retirement Survey 2014, a survey of non-retired individuals with investments or retirement accounts. The study notes there were 4,393 valid complete responses. The analysis also draws on data from IXI Services, reportedly representing approximately 20% of U.S. consumer invested assets on a household level and approximately 30% of U.S. consumer invested assets on an account level.

Part II starts out by demonstrating that advised individuals had more financial assets than non-advised individuals. This pattern was borne out in data from both Oliver Wyman's own investor survey and from IXI Services. The Oliver Wyman study does not discuss causality, leaving open the possibilities that advisers enrich their clients or that wealthier investors are more likely to seek advice than their less wealthy counterparts. The study merely establishes a correlation, does not discuss the direction of causality, and does not recognize that financial advisers cannot claim full credit for the greater wealth of advised individuals.

Part II continues with arguments that individuals with a financial adviser are better investors along several dimensions:

- A. *Developing and maintaining a personalized financial plan.* This section (Oliver Wyman 2015, pp. 18-23) mostly draws on external research into why households save, what they value in advisers, how commonly they use plan advice offered through their DC plan, how much they contribute to their DC plan, why they roll over DC assets into an IRA, and how common DC plans and IRAs are. None of this demonstrates (or even suggests) that advised individuals are more likely to develop and maintain a personalized financial plan than non-advised individuals. More generally, none of it compares individuals with and without a financial adviser, with a partial exception in the finding that DC plan participants who used "at least one type of support contributed an average of 2.0 percentage points more of their salary to a DC plan (6.7% vs. 4.7%)" (Oliver Wyman 2015, p. 20). The support types alluded to here included educational materials, tools, and advice options, i.e.,

- more types than just financial advisers. The study does not discuss causality, and indeed causality may go both ways: educational materials and other support types may prompt some DC plan participants to increase their contributions, and people with sizable DC plan balances may be more likely to seek support because they have more at stake than people with small balances.
- B. *Commitment to regular saving and investment.* This section shows that households with a financial adviser are more likely to own an IRA and that their average IRA balance is higher than that of non-advised households. External data show similar patterns for DC plans. Again, the study does not discuss causality, and indeed causality may go both ways: financial advisers may nudge people to save more in IRAs or DC plans, and people with large IRA or DC plan balances may decide to seek professional advice because they have more at stake than people with small balances.
- C. *Constructing and maintaining a well-diversified portfolio of appropriate investment products.* This section shows that advised households own more diversified portfolios than non-advised households. We agree that, all else equal, a well-diversified portfolio is generally preferable over a highly concentrated portfolio. However, the advice and the diversification are not free of charge, and a central issue is whether the diversification as advised by financial advisers generated long-term benefits. The Oliver Wyman study is silent on issues of cost and rates of return, but several academic studies suggest that the net contribution of certain financial advisers on portfolio performance is negative.<sup>24</sup> Indeed, several portions of the Oliver Wyman study are suggestive of expenses incurred with diversification. For example, “Non-advised individuals hold 70% more of their equities exposure in individual securities compared to advised individuals” (Oliver Wyman 2015, p. 28). Accepting for now that individual securities are indicative of a lack of diversification, investors incur expenses in the leading alternative—mutual funds—in the form of front-end sales loads and expense ratios. Also, Figures 20 and 21 show that advised individuals hold far more of their portfolios in variable annuities than non-advised individuals. Variable annuities are widely known to be subject to high fees.<sup>25</sup>
- D. *Staying invested in the market.* This section shows that advised individuals hold less cash, as a fraction of their portfolio or IRA, than non-advised individuals. It further asserts that “Financial advisors help individuals avoid premature IRA distributions — 76% of heads of households that made traditional IRA withdrawals in 2013 were retired” (Oliver Wyman 2015, p. 34). The assertion appears to be based on a finding that most (88%) IRAs are held in a brokerage model, where the account holder has access to a financial adviser. However, the Oliver Wyman study does not present statistics about withdrawals by non-advised individuals and its evidence does not support the conclusion that financial advisers help avoid premature IRA distributions.
- E. *Periodically re-balancing investment holdings to restore desired asset allocation and risk levels.* This section shows that advised individual rebalance certain portions of their portfolio more frequently than non-advised

---

<sup>24</sup> See, for example, the studies reviewed in Council of Economic Advisers (2015).

<sup>25</sup> See, for example, Kaplan (2012) and Scism (2012).



individuals. Similar to the above discussion related to portfolio diversification, we agree that, all else equal, rebalancing is generally desirable. However, there may again be costs associated with selling assets and buying other assets, and front-end load fees in particular can erase any benefits of rebalancing. The Oliver Wyman study is silent on such costs.

The arguments that individuals with a financial adviser are better investors apparently are intended to convince the reader of the value of financial advice. However, the Proposed Rule is concerned with conflicted advice only, not with financial advice in general. The Oliver Wyman Retail Investor Retirement Survey 2014 does not define what it means with “financial adviser,” how it asked the respondents whether they consulted a financial adviser, or how the adviser was compensated. Given the focus of the study and the fact that Oliver Wyman designed its own survey, it is puzzling why Oliver Wyman did not distinguish conflicted and non-conflicted advice. It appears Oliver Wyman assumed that conflicted advice is as valuable as non-conflicted advice. Also see our discussion of common themes in Section 2.

The study also does not consider whether non-advised individuals participate in other retirement vehicles such as DC plans. These individuals may place a higher emphasis on their DC assets which could explain some of the differences in account characteristics such as average IRA balance and diversification of their portfolios. For example, in a study on mutual fund ownership through investment professionals, Schrass (2013, p.8) finds that “mutual fund–owning households without advisory relationships were more likely to hold mutual funds only through employer-sponsored retirement plans”.

In short, Part II of the Oliver Wyman study shows that financial advisers tend to be involved with relatively successful individual investors, but it does not address to what extent financial advisers deserve credit for that success, it does not address whether the price individual investors pay for financial advice exceeds the benefits, and it fails to single out conflicted advice.

## **Data Issues**

As noted earlier, much of the analysis in the Oliver Wyman study is based on a survey of small businesses, a survey of individual investors, and data from IXI Services. We now discuss each data source in turn.

### ***Oliver Wyman Small Business Survey 2014***

According to the “Survey methodology” section (Oliver Wyman 2015, p. 40), the Oliver Wyman Small Business Survey 2014 is a survey of owners and HR decision makers of payroll-based businesses with between 1 and 100 employees. Among others, it formed the basis of the claim that small businesses with a financial adviser are more likely to set up a retirement plan than businesses without a financial adviser. See the study’s Figure 7, transcribed here in Table 2.<sup>26</sup>

---

<sup>26</sup> As discussed above, Oliver Wyman’s use of the term “plan formation rates” is misleading; the rates refer to plan sponsorship. Also see the labeling of the study’s Figure 7 (“Percent of businesses offering retirement plan”).

**Table 2. Plan Sponsorship Rates by Size of Firm and Adviser Status**

	Number of employees			Overall
	1-9	10-49	50-100	
With a financial adviser	51%	77%	89%	69%
Without a financial adviser	26%	52%	75%	46%
Overall	36%	63%	80%	56%

Source: Oliver Wyman Small Business Retirement Survey 2014.

The plan sponsorship rates in Table 2 are substantially higher than nationwide sponsorship rates among small businesses reported elsewhere. For example, according to the Bureau of Labor Statistics (2014), 45% of establishments with 1-99 employees sponsored a retirement plan in 2014.<sup>27</sup> In contrast, the Oliver Wyman survey reported a rate of 56%. Also, according to tabulations by Brady and Bogdan (2014) and Copeland (2014), 17% of employees at firms with 1-9 employees had access to a retirement plan at work, whereas the Oliver Wyman survey suggested as many as 36% of firms with 1-9 employees sponsored a plan.<sup>28</sup> There are differences between Oliver Wyman's survey results and external sources within the report itself. For example, Figure 4, which is based on a Social Security Administration study (Dushi et al., 2011, Table 2), shows that 70% of employees at firms with 50-99 employees had access to a retirement plan, whereas Figure 7 reports that 80% of firms with 50-100 employees sponsor a retirement plan.<sup>29</sup> Such differences in a key metric call into question the validity of the Oliver Wyman Small Business Retirement Survey 2014. More generally, the Oliver Wyman study provides few details about the small business survey's design, sampling frame, questionnaire, response rate, or implementation.

### ***Oliver Wyman Retail Investor Retirement Survey 2014***

The "Survey methodology" section (Oliver Wyman 2015, p. 40) explains that the Oliver Wyman Retail Investor Retirement Survey 2014 was stratified by age, income, and the presence of a financial adviser. It does not state from what sampling frame the sample was drawn. Even though income was used for stratification, sampling weights were based on assets not income (Oliver Wyman 2015, p. 40.) The authors defend their unusual approach as follows: "Although we sampled based upon age, income and the presence of a financial advisor, we scale our sample to the population using age, assets, and the presence of a financial advisor, as the distribution of household assets is better documented in secondary sources than the distribution of personal income" (Oliver Wyman 2015, p. 40). They subsequently state that they used the Survey of Consumer Finances (SCF) to calculate sampling weights. However, the SCF contains detailed questions about individual and

<sup>27</sup> Some of these establishments belonged to a larger firm with multiple establishments. Since plan sponsorship tends to increase with firm size, the Bureau of Labor Statistics figures imply that sponsorship among firms with 1-99 employees was less than 45% in 2014.

<sup>28</sup> The unit of observation of Brady and Bogdan (2014) and Copeland (2014) was an employee and that of the Oliver Wyman survey, a firm. Since sponsorship rates tend to increase with firm size and larger firms employ more people, the employee-weighted rate is higher than the firm-weighted rate. The actual discrepancy is thus even larger than the difference between 17% and 36%.

<sup>29</sup> The actual discrepancy is again larger because Figure 4 is employee-weighted and Figure 7 is firm-weighted; see footnote 28.

household income, raising questions why Oliver Wyman chose assets instead of income to calculate sample weights.

Another issue relates to the definition of a “financial adviser.” The study does not define the term for its stratification purposes or for its weighting purposes. It states only that weighting was based on the 2013 SCF. However, the SCF did not ask about “financial advisers.” It did ask about sources of information used to make decisions about saving and investments. The SCF respondent could choose from a number of options, including lawyer, accountant, banker, broker, and financial planner, but “financial adviser” was not among the options. It thus remains unclear how to interpret the study’s use of the term “financial adviser.” The study does not even report what fraction of households in its survey consulted a financial adviser, other than “By one measure, 58% of households with under \$100,000 in investable assets, and 75% of non-retired households with over \$100,000 in investable assets, solicit professional financial advice” (Oliver Wyman 2015, p. 19 and attributed to the SCF). In our own analysis of the SCF we were unable to replicate these rates, but roughly approached them by including bankers, brokers, financial planners, dealers, and insurance agents. Perhaps these categories jointly formed the basis of the statement about advice rates, but we cannot think of a data source that could serve as the sampling frame for the survey’s stratification by presence of a financial adviser in any of those categories. The Oliver Wyman Retail Investor Retirement Survey 2014 likely used another definition. However, the Oliver Wyman study provides few details about the investor survey’s design, sampling frame, questionnaire, response rate, or implementation. Lack of public access to the survey and the discrepancies noted above do not enhance the credibility of the Oliver Wyman study.

### ***IXI Services***

In addition to its proprietary investor survey, Part II of the Oliver Wyman study relied on data from IXI Services. Even though it repeatedly refers to these data as household-level or account-level data (e.g., footnotes 25, 36, 40, 42, 43, 44, 47, 48, and 49), it is our understanding that Oliver Wyman did in fact not analyze account-level or household-level data from IXI Services. Instead, the data appear to have been aggregated to segment-level information: “Our analysis leveraged IXI Services data containing segment-level detail on U.S. consumer invested assets. Segments were defined by specific age tiers (five), income tiers (eleven), wealth tiers (seven), advisor relationship type (Full Service Brokerage vs. Discount Brokerage) and year” (Oliver Wyman 2015, p. 41). The same page explains that IXI data contain information on total segment assets, total segment number of households, et cetera.

Indeed, results from IXI Services data tend to be phrased in awkward and potentially misleading terms. For example, “94% of households examined belonged to an age / income / wealth segment in which advised households held  $\geq 25\%$  more IRA assets compared to nonadvised households” (Oliver Wyman 2015, p. 23). Or, “72% of households belong to a segment in which advised households hold more than 20% less of their assets in equities” (Oliver Wyman 2015, p. 27). Such segment-level statements can be misleading, in part because either all or none of the households in a segment support the statement without regard to differences within segments.

## 5. INVESTMENT COMPANY INSTITUTE

### *Summary*

In response to DOL's Proposed Rule, Brian Reid and David W. Blass of ICI filed a comment letter in July 2015 (ICI 2015a) and follow-up letters in September 2015 (ICI 2015b) and December 2015 (ICI 2015c). This section contains a review of ICI's comments.

ICI's comments criticize certain academic studies upon which DOL relied in estimating the impacts of the Proposed Rule. Separately, ICI presents alternative estimates of the performance of funds with front-end loads, with the primary conclusion that no-load funds outperform funds with front-end loads by an annual average of only 7 bps. Further, ICI asserts that the Proposed Rule would effectively eliminate accounts with front-end loads, resulting in increased annual costs for investors with assets over \$100,000, which in turn would reduce annual returns by 61 bps as these investors migrated to fee-based arrangements. Finally, ICI asserts that the Proposed Rule will eliminate advice for investors with accounts under \$100,000, resulting in a 300 bps reduction in annual returns for those investors. ICI's assumptions and calculations produce an estimate of increased costs to investors of \$18.8 billion in the 10<sup>th</sup> year.

Our primary conclusions are that (1) ICI's criticisms of the academic literature and front-end load performance results do not undermine DOL's estimates of the benefits from reducing conflicted advice and (2) ICI's estimates of the costs to investors of having to pay more for and/or losing financial advice are based on unsupported assumptions that are contradicted by information provided by other commenters. In particular, not only do ICI's criticisms of the academic literature fail to undermine DOL's interpretation of those studies, ICI's finding that the average annual returns for no-load funds exceed the annual returns for front-end load funds by 43 bps—the result that most closely aligns with the academic study DOL used in the RIA—is reasonably close to the estimated benefit from less conflicted advice described in the RIA.

With regard to ICI's estimates of the cost of the Proposed Rule, ICI offers no support for its assumptions that investors currently selecting front-end load funds would either have to pay as much as more active incumbent fee-based investors or lose access to advice. The first assumption ignores the likely emergence of new fee structures or products to continue to service investors that ICI characterizes as placing less demand on financial advisers. ICI's companion assumption that investors with balances under \$100,000 would no longer receive financial advice is inconsistent with the fact that a large proportion of investors with accounts at or below this level have the fee-based accounts that ICI presumes are too costly to provide.

### *Synopsis*

ICI's comments criticize certain academic studies upon which DOL relied in estimating the impacts of the Proposed Rule. Separately, ICI presents alternative estimates of the performance of funds with front-end loads, with the primary

conclusion that no-load funds outperform funds with front-end loads by an annual average of 7 bps. Further, ICI asserts that the Proposed Rule would effectively eliminate accounts with front-end loads, resulting in increased annual costs for investors with assets over \$100,000, which in turn would reduce annual returns by 61 bps as these investors migrate to fee-based arrangements. Finally, ICI asserts that the Proposed Rule will eliminate advice for investors with accounts under \$100,000, resulting in a 300 bps reduction in annual returns for those investors. ICI's assumptions and calculations produce an estimate of increased costs to investors of \$18.8 billion in the 10<sup>th</sup> year.

## ***Discussion***

### **ICI's Criticisms of Academic Literature**

Because DOL's quantitative estimates of the impact of the Proposed Rule rely heavily on the results presented in Christoffersen et al. (2013), ICI focuses the majority of its criticisms on this article.<sup>30</sup> These criticisms, which generally overlap with those of other commenters, include<sup>31</sup> (1) the study does not measure the effect of the difference between fiduciary and broker advice,<sup>32</sup> (2) the age of data used in the study,<sup>33</sup> (3) the application of the relationship between *excess load* (broker compensation in excess of the expected level) and fund performance to changes in the *average load*, and (4) the fact that Christoffersen et al.'s analysis was not weighted by assets or sales.<sup>34</sup>

In Section 2 (Common Themes) we address each of these criticisms. With regard to the need for a direct measure of the effect of the difference between fiduciary and broker advice, while we are not aware of publicly available studies that explicitly compare the effects of fiduciary and broker advice, the academic literature upon which DOL relies addresses underperformance due to conflicts of interest. This focus is consistent with the target of DOL's Conflict of Interest Proposed Rule.

Because DOL applies a *relationship* between broker compensation and fund performance to compensation levels expected to occur under the Proposed Rule, ICI's concern about the age of the data is misplaced. ICI replicates Christoffersen et al.'s (2013) regression model with data from 2010 to 2014, which demonstrates the robustness of the relationship DOL applied in its impact analysis (ICI 2015c, p. 9):

---

<sup>30</sup> The authors' letter responding to ICI's criticisms concluded that none of them are valid; see Christoffersen and Evans (2015).

<sup>31</sup> ICI also criticizes Christoffersen et al.'s relationship between fund inflows and broker compensation. Since DOL's calculations did not rely on this relationship, we do not address this criticism.

<sup>32</sup> "Christoffersen et al. do not measure or test whether these returns were lower than what investors would have received had they used a fiduciary adviser" (ICI 2015a, p. 13).

<sup>33</sup> "The sample period in the paper extends from 1993 to 2009, relying largely on fund performance that is 10 to 20 years old" (ICI 2015a, p. 13).

<sup>34</sup> "Nor does the paper provide asset-weighted or sales-weighted returns to demonstrate how investors who use broker-sold funds perform as a group relative to those using similar funds in their Morningstar category" (ICI 2015a, p. 13).

The results in the second-stage regression are also in all their important elements very similar to those reported by CEM [Christoffersen et al. 2013] [...] We find a coefficient estimate on the residual load fee paid to unaffiliated brokers of -0.64 percent, which implies *an even larger effect than the -0.4972 coefficient reported in CEM.* (Emphasis added)

While the data used in academic studies may be dated, findings on incentive effects remain valid; see Section 2.

Contrary to ICI's claims (and those of others), DOL applied the relationship between fund performance and excess load properly. In particular, as explained in Section 2, Christoffersen et al. use their relationship the same way as DOL has to explain how performance improves when front-end loads are reduced. Whether some funds are above average and others are below average is irrelevant; the model is applicable to all funds when loads change.

ICI's specific criticism is that while Christoffersen et al.'s relationship between front-end load paid to brokers and performance is the result of a regression model that explains the annual returns of a fund in excess of its Morningstar category average by the excess front load payments,<sup>35</sup> Christoffersen et al. and the RIA apply the results to the total load paid to brokers, not the excess load. In particular, ICI (2015a, p. 15, emphasis in original) states:

When they attempt to measure the economic significance for the investor, they incorrectly multiply the coefficient of the "excess load" variable by the *average load paid*, and argue that the typical fund underperforms by 1.13 percent annually. But the regression relating fund performance and loads was not run using actual load, but using "excess load." The residuals from their first regression measuring the "excess load" should have a mean of *zero*. Taking the results from their analysis literally, they should conclude that the average broker-dealer funds neither underperform nor outperform their Morningstar category average.

DOL's application of the relationship between excess loads and fund performance is valid because a reduction in load would improve a fund's performance regardless of whether the fund in question paid brokers an above-average amount (in which case excess load would be positive) or a below-average amount (in which case excess load would be negative). Accordingly, ICI's (and NERA's) criticism is invalid. While it is true that residuals have a zero mean,<sup>36</sup> Christoffersen et al. and the RIA are not using the model to explain the average effect over all funds used to estimate the model, but rather the effect of an overall *change* in excess load.<sup>37</sup>

---

<sup>35</sup> The excess load variable is calculated as the actual payment to brokers minus payment predicted by a regression model that explains payments to brokers as a function of fund characteristics and whether the broker is captive or unaffiliated.

<sup>36</sup> Because the number of observations (163,347) in the regression model that produced the residuals (Christoffersen et al. 2013, p. 217) is somewhat larger than the number of observations (113,153) in the regression model explaining performance (Christoffersen et al. 2013, p. 226), the average of the residual used as an independent variable in the latter would not necessarily be zero.

<sup>37</sup> ICI reiterates its criticism in its December 2015 letter to DOL:

Finally, while weighting often makes sense when calculating averages, Christoffersen et al. did not calculate such an average, but instead developed the relationship between excess load and fund performance. As we discussed earlier, there is no requirement in econometric theory or practice for the observations used to establish such a relationship be weighted when they differ in size by some measure.<sup>38</sup> In fact, in its latest comment (ICI 2015c, p. 3) now agrees that there is no problem with the Christoffersen et al. relationship:

The Department needed to weight the research findings taken from the CEM study by assets or sales of fund shares. This problem remains *even though* the CEM study properly adjusted for the levels of funds' assets in its regressions. The CEM study, like most of the other academic studies the RIA cites, conducts its analysis at the fund level. The RIA seeks to convert this fund-level analysis into aggregate dollar effects on the total IRA assets invested through broker-sold funds. To translate fund-level findings into *market-level* dollar effects, the Department would need to weight the fund-by-fund effects predicted by the CEM regression by the asset levels or sales of those funds. The RIA did not do that.

ICI's claim is incorrect. Because DOL applied the relationship to the *change* in excess load expected from the Proposed Rule and that change is asset-weighted, DOL's calculation is a proper application of Christoffersen et al.'s regression relationship.<sup>39</sup>

---

The Department did in fact misapply a regression coefficient taken from the CEM study. To be clear, this has very little to do with the results in the CEM study, which stand on their own merits [...] The Department erred by applying the CEM coefficient to the front-load paid to brokers rather than to the residual load paid to brokers, inflating the Department's estimate of the benefit of its proposed regulation. (ICI 2015c, p. 3.)

As a preliminary matter, DOL applies Christoffersen et al.'s results the same way the authors themselves apply the relationship between excess load and performance (Christoffersen et al., 2013, p. 228). More fundamentally, the regression relationship is properly applied to the *change* in the variable affected by the policy and not the current level of the variable as ICI suggests. ICI's misguided approach is analogous to a study which first centered the data, estimated a relationship between a key independent variable and the dependent variable, and then insisted that the coefficient be used with the mean of the key variable (which would be zero by construction) and from this exercise concluding that there was no effect.

<sup>38</sup> Christoffersen and Evans (2015, p. 2) provide an explanation why their econometric approach did not require asset weighting.

<sup>39</sup> To see why, note that the relationship is being applied to the change in excess load. Therefore, at the individual fund level, the model would produce the following:  $\Delta\text{return}_i = \beta \Delta\text{load}_i$ , where  $\beta$  is the regression coefficient,  $\Delta\text{return}_i$  is the predicted change in return for fund  $i$ , and  $\Delta\text{load}_i$  is the change in excess load for fund  $i$  expected from the Proposed Rule. The overall change in return is obtained by weighting the predictions for each fund, and then summing them.

$$\Delta\text{return} = \sum w_i \Delta\text{return}_i = \sum w_i (\beta \Delta\text{load}_i) = \beta \sum w_i \Delta\text{load}_i = \beta \Delta\text{load}.$$

## ICI's Analysis of Front-End Load Fund Performance

ICI reports average returns of front-end mutual funds in a number of ways. The results, which are based on Morningstar data, include returns for domestic equity, international equity, taxable bond, and balanced funds. ICI does not provide the specific data used to produce the results (to the extent those data differ from data readily available to other users), nor does it provide details often available in academic articles, such as the definitions of the fund categories and the number of observations used to calculate average returns.

ICI's calculations start with annual returns, net of expenses, for 2008-2014. ICI describes the calculation as follows (ICI 2015a, p. 16):

To measure the experience in broker-sold share classes, we use gross sales and assets of front-end load share classes from 2007 through 2013 and measure the performance of these share classes or their funds in subsequent years to capture what investors would have experienced if they stayed in their funds. The reason for focusing on the more recent time period is that the mutual fund market has changed significantly in the past twenty years, as we discussed in Section II. We then calculate fund returns, net of fund fees, based on Morningstar data.

As a baseline, we take one-year net returns of share classes with front-end loads from 2008 through 2014 and subtract each share class's Morningstar category return from the same year to create a relative return.<sup>40</sup> To measure how investors as a group using front-end share classes perform, we then weight each fund's relative performance in the subsequent one-year period by sales or assets from the reference year. Similar measures are used for retail no-load funds to provide a basis for comparison.

Table 3 lists ICI's return results.

**Table 3. Front-End and No-Load Fund Returns Calculated by ICI (Annual Percent Relative to Morningstar Category Average)**

Measure	Front-End			Source
	Load	No Load	Difference	
Simple Average	0.13	NA	NA	Figure 2
<b>Sales Weighted</b>	<b>0.27</b>	<b>0.70</b>	<b>0.43</b>	Figure 4
Average of yearly returns_sales weighted	0.16	NA	NA	Figure 3
Average of yearly returns_asset weighted	0.15	NA	NA	Figure 3
Average of yearly 3-year returns_sales weighted	0.17	0.44	0.27	Figure 5
Average of yearly 3-year returns_asset weighted	0.37	0.65	0.28	Figure 5

Table 3 demonstrates the following.

- ICI observed that the average net return, relative to Morningstar categories, was 27 bps with a sales-weighted average and 13 bps with a simple

<sup>40</sup> ICI (ICI 2015b, p. 3) characterized its approach as being the same as that used by Christoffersen et al. (2013) and other academic studies.



average.<sup>41</sup> ICI (2015a, p. 17) credits brokers for this outcome: “The fact that the sales-weighted average exceeds the simple average suggests that brokers tended to guide their clients to funds that subsequently slightly outperformed, not underperformed.”<sup>42</sup>

- The approach that most closely aligns with DOL’s use in the RIA of Christoffersen et al.’s (2013) findings is the sales-weighted approach shown in the highlighted, second row. ICI finds that load funds underperform no-load funds by 43 bps. To put this difference into perspective, the RIA (DOL 2015, p. 115) estimates that reducing conflicted advice would increase annual returns by about 50 bps in the latter years of the 2017-2026 period (first scenario).
- ICI reports averages of one-year returns for 2007 through 2013 on sales-weighted and asset weighted bases. These averages are lower than the overall average reported in the second row (0.16 percent or 0.15 percent versus 0.27 percent), with only a minimal difference between the sales-weighted and asset-weighted results.
- ICI also reports the averages of three-year returns for the period 2007-2011.<sup>43</sup> The superior performance of the no-load funds is 27 or 28 bps for these comparisons. In contrast to the minimal difference in one-year returns listed in the third and fourth rows, ICI’s asset-weighted three-year returns are curiously about 20 bps higher than the corresponding sales-weighted returns.

In addition to reducing the performance gap between no-load and front-end load funds by introducing three-year returns, ICI (2015a, p. 21) adds back 12b-1 fees, which reduces the performance gap by an additional 20 bps. Christoffersen et al. (2013) did *not* make this adjustment. ICI then uses the resulting gap of 7 bps to quantify the net costs it attributes to the Proposed Rule, which we discuss in the following sections.

The appropriateness of adding 12b-1 fees to investment returns is debatable. Presumably, the argument is that they serve to compensate brokers for their services, just like fees do in fee-based accounts. In a recent paper that was also cited by ICI (2015c), Reuter (2015, p. 6) observes that adding back 12b-1 fees “is reasonable except to the extent that conflicts of interest lead brokers to recommend funds that charge higher 12b-1 fees in order to pay higher commissions.” Also, one could argue that the broker was already compensated through a share of the front-end load at the time of purchase; it is unclear whether investors are aware that they continue to pay the broker for as long as they own the fund and whether they would consider the 12b-1 fees as part of their rate of return.

---

<sup>41</sup> The average for sales-weighted front-end load funds listed in the second row differs from the corresponding average in the third row because the former is a single average for the entire period, while the latter is the average of the annual averages.

<sup>42</sup> Whether brokers encouraged investors to select better-performing front-end load funds is a different issue from whether brokers advised investors to select front-end load funds that underperformed alternative funds, such as no-load funds.

<sup>43</sup> The end of the three year period for calculating a three-year return for funds sold in 2011 is 2014—the last year of the data used by ICI.

In summary, rather than demonstrating errors in Christoffersen et al. that cause the results in the RIA to “collapse” (ICI 2015a, p. 5), ICI’s result that most closely aligns with Christoffersen et al.’s approach—the 43 bps superior performance of no-load funds as measured by one-year net returns—is quite similar to the approximately 50 bps impact in the RIA’s first scenario.<sup>44</sup> The narrower gap claimed by ICI required changes—the use of three-year returns and the adding back 12b-1 fees—from the measurements used in the Christoffersen et al. study.<sup>45</sup>

## ICI’s Claims about Increased Costs for Larger Investors

ICI (2015a, p. 25) also claims that the Proposed Rule will result in fewer investors being able to select commission-based funds:

[T]he BIC exemption is unworkable; even if could work, it would impose prohibitive costs on brokers. Brokers subject to the Exemption’s many limitations, burdens, and costs, as well as its increased exposure to liability, are likely to seek to move many of their clients to fee-based accounts. Such accounts, however, require a much greater level of time and engagement through frequent rebalancing of investors’ accounts a level of service that is unnecessary for an investors with a modest balance who is typically better off as a buy-and-hold investor. This additional ongoing engagement results in higher and ongoing expense to the investor.

As explained in more detail below, ICI assumes that the shift from commission-based to fee-based accounts would eventually reduce annual returns to investors by 61 bps, which would exceed the 7 bps gain from reduced conflicted advice by 54 bps. As described in the next section, ICI also assumes that investors with balances under \$100,000, which according to ICI account for 19 percent of current front-load IRA funds, would no longer receive any financial advice; therefore, ICI assumes that investors accounting for 81 percent of assets in traditional IRAs would be shifted to fee-based accounts. By the tenth year, by which time ICI’s calculations assume that account balances that existed before the rule would have fully turned over,<sup>46</sup> ICI

---

<sup>44</sup> ICI’s result is also very similar to Reuter’s (2015, p. 13) conclusion:

Within the broader sample of actively managed funds [...] the difference is 0.47% if I focus on category-adjusted after-fee returns and 0.20% [...] if I add back 12b-1 fees. To the extent that conflicts of interest lead brokers to recommend funds with higher-than-average 12b-1 fees (as performance differences between active and passive broker-sold funds suggest), the actual performance difference within the broader sample of actively managed funds is likely to fall between 0.47% and 0.20%.

<sup>45</sup> There are additional methodological differences that would need to be considered in order to explore fully the differences between ICI’s and Christoffersen et al.’s results. For example, Christoffersen et al. (2013, page 226) controlled for a number of factors, such as fund size, inflows, and redemptions, while ICI’s analysis reports no such controls. Not accounting for such factors could cause results such as averages or weighted averages to be biased.

<sup>46</sup> ICI uses the asset turnover distribution from the RIA (DOL 2015, p. 114, Table 3.4.1-2), which posits that 16.8 percent of assets turn over in the first year, with declining percentages in subsequent years so that all assets have turned over by the 10<sup>th</sup> year.

estimates that the net cost to investors who were shifted to fee-based accounts would be \$8.2 billion.<sup>47</sup>

ICI provides no analysis or quantitative estimates of how many accounts would be moved from commission-based to fee-based and the level of assets associated with such moves. Instead, ICI simply assumes that *all* investors in commission-based accounts would either be moved to fee-based accounts and pay more in fees as a result or have balances not sufficient for advisers being willing to service the accounts. As discussed in Section 2, this presumption is contradicted by evidence from other countries.

ICI's (2015a) calculations ignore that a portion of IRAs is held in discount brokerage accounts. These account holders do not receive advice, and their accounts are not affected by the Proposed Rule. ICI's (2015a) calculations of the share of accounts and assets that will migrate or lose access to advice are thus overstated.

For those investors whom ICI assumes will be shifted to fee based accounts, ICI assumes that costs would increase by the *average* difference of 61 bps between expenses for fee-based (average of 111 bps) and commission-based (average of 50 bps) accounts. In other words, rather than account for the lower demands incumbent commission-based investors impose by introducing new fee structures or new products, ICI casually assumes that advisers will charge them fees based on services that they do not demand, such as frequent rebalancing. ICI did not discuss the possibility that because of their lower trading volumes and account turnover, current commission-based investors who had to migrate to fee-based accounts (or perhaps some other mechanism) would probably not be as costly to serve as incumbent fee-based investors.

### **ICI's Claims about Loss of Advice for Smaller Investors**

ICI (2015a, p. 27) further assumes that investors with smaller account balances would completely lose financial advice:

[F]ee-based accounts may not be available to low- and middle-income IRA investors who cannot meet minimum account balance requirements. Currently, fee-based advisers often require minimum account balances of \$100,000 [...]

ICI (2015a, pp. A-1 to A-2) further assumes that investors losing advice will eventually experience annual returns that are 3% lower than the returns they earned in front-end load accounts:

We assume that these assets underperform by 3 percent a year compared to their performance with a broker [...] The 3 percent underperformance reflects lower allocation to stocks and higher allocation to cash, early withdrawals and elimination of tax deferral, and poor market timing decisions.

ICI's calculates the impact of lost advice by combining the two assumptions—investors holding 19% of assets experience a 3% loss in annual return. By the tenth year, ICI estimates that the net cost to investors who lost investment advice would

---

<sup>47</sup> ICI (page A-3) adopts DOL's projection of \$1.868 trillion in assets by the 10<sup>th</sup> year. Therefore, ICI's estimate of \$8.2 billion = 1,868 x 0.0054 x 0.81.

be \$10.6 billion.<sup>48</sup> Combined with the loss from investors with accounts in excess of \$100,000 discussed in the previous section, ICI (2015a, p. 30) reports a total loss of \$18.8 billion by the tenth year.<sup>49</sup>

ICI provides no support for either of its assumptions, both of which are inconsistent with information provided by other commenters. With regard to the loss of advice, the results of NERA's database of over 63,000 accounts show many fee-based accounts with balances well under \$100,000 (NERA 2015a and 2015b). Table 4, constructed from NERA's results, displays this information.

**Table 4. Fee-based and Commission-based Accounts by Account Size**

Balance	Fraction of fee-based accounts	Fraction of commission-based accounts	Percentage of accounts that are fee-based
\$1K-\$10K	2%	23%	3.5%
\$1K-\$25K	9%	41%	8.4%
\$1K-\$50K	22%	57%	13.8%
\$1K-\$100K	42%	72%	19.5%
\$1K-\$250K	72%	87%	25.6%
\$1K-\$1M	97%	98%	29.1%
\$1K+	100%	100%	29.4%

Source: NERA (2015a, 2015b).

The first two columns display the cumulative distributions of fee-based and commission-based accounts by account size. For example, 2% of fee-based accounts have balances from \$1,000 to \$10,000 and 42% have balances of \$100,000 or less. ICI's assumption that accounts with balances less than \$100,000 would be too costly to serve cannot be reconciled with the fact that a large proportion of fee-based accounts have balances below \$100,000. The last column of the table shows the proportion of accounts that are fee-based. In particular, 19.5 percent of accounts in NERA's database with balances of \$100,000 or less are fee-based accounts.

Since ICI does not indicate how it determined that lost advice would reduce annual returns by 3%, it is not possible to evaluate how ICI reached this conclusion. For example, unlike Litan and Singer (2015a), and the Vanguard (2014a) document upon which they rely, ICI provides no detail on factors such as the specific losses that stem from lost advice (e.g., better rebalancing increases returns by x percent) or on the proportions of investors currently relying on such advice (but presumably no longer would be able to do so). Further, ICI's estimate of a 3% loss far exceeds the flawed and inflated 44.5 bps loss Litan and Singer (2015a) attribute to lost advice; see Section 7. Finally, experiences from other countries suggest that banning conflicted advice may in fact not reduce access to advice (Europe Economics, 2014).

<sup>48</sup> ICI (2015a, page A-3) adopts DOL's projection of \$1.868 trillion in assets by the 10<sup>th</sup> year. Therefore, ICI's estimate of \$10.6 billion = 1,868 x 0.03 x 0.19.

<sup>49</sup> ICI's estimate excludes the benefit from less conflicted advice for investors with accounts under \$100,000.

## 6. COMPASS LEXECON

### *Summary*

In response to DOL's Proposed Rule, Compass Lexecon wrote a comment titled "Tax Consequences to Investors Resulting from Proposed Rules Relating to Financial Representative Fiduciary Status" (Compass Lexecon 2015). This section contains a review of the Compass Lexecon comment.

The Compass Lexecon comment states that as a result of the Proposed Rule, commission-based IRA accounts with balances under \$25,000 will lose access to advice. If, in order to preserve access to investment advice, investors opt to use a taxable savings account instead, these investors may experience a reduction in retirement savings. The comment focuses on quantifying the effect of this hypothetical migration to taxable savings accounts. We agree that *if* investors use taxable savings accounts instead of IRAs to fund their retirement, then they may experience reduced savings. However, we disagree with Compass Lexecon on the extent to which retirement investors will forego tax-sheltered accounts.

Among the households that Compass Lexecon identifies as at-risk, some households are presumably already in a commission-based advice relationship and some are not. Among investors already in a commission-based relationship, there may be a small subset of investors who want to preserve their *existing* relationship with their adviser and the advisory firm at all costs. That is a theoretical possibility and it can be accomplished using the Proposed Rule's carve-outs and exemptions. But given the presence of numerous comparable alternatives, we estimate this subset to be overstated in the Compass Lexecon comment. Among new investors who do not have an existing relationship, the desire to create a new relationship with an adviser using a taxable savings mechanism is expected to be even smaller.

The Compass Lexecon comment provides little to no analysis of the likelihood of investors switching to taxable savings accounts. Instead, in quantifying potential losses from investors using taxable, rather than tax-deferred accounts, it simply assumes that the bottom half of investors using brokerage accounts would use taxable accounts instead.<sup>50</sup> Given the current options available to investors as well as alternatives that are being introduced in the fast evolving market for investment advice, we do not foresee a consequential number of investors making this switch to taxable accounts. Current and future investors with small asset balances who seek access to investment advice already have many options to choose from. Industry trends suggest even more options may become available to them.

Also, Compass Lexecon erroneously assumes that IRAs that start small (under \$25,000) will grow to be average at the time of retirement. Instead, IRAs that start relatively small are likely to remain relatively small.

---

<sup>50</sup> Compass Lexecon (2015, pp. 19-20). More precisely, Compass Lexecon assumes that one-half of IRAs in brokerage accounts would not have had \$25,000 when the accounts were opened.

In short, while we agree that tax-sheltering can be beneficial to IRA investors, the Compass Lexecon comment relies on unsupported or incorrect assumptions on investor behavior to make overly dire predictions on eroded retirement savings.

## ***Synopsis***

The basic premise of the Compass Lexecon comment is that the Proposed Rule may cause an investor who would have opened an IRA to instead open a taxable savings account in order to preserve access to a commission-based account and the assistance that comes with it. Specifically, it expects firms currently offering commission-based IRAs will no longer find it cost-effective to offer IRAs to small account holders, such as those with a balance below \$25,000. However, firms could still offer brokerage-based taxable accounts. If investors opt for a taxable account in order to gain or retain access to advice, they will lose tax deferral benefits and end up with fewer retirement savings that will not fund their retirement for as long as investors utilizing an IRA can expect.

Section I of the comment provides background and summarizes the rationale, approach and findings of the analysis conducted. In Section II, the comment describes the model used to analyze the reduction in retirement savings, the assumptions made and other parameters used to develop the model. Section III describes how the model operates, compares different investment mechanisms (taxable savings account versus a traditional IRA and a Roth IRA), and explains the simulation techniques used to evaluate the uncertainty embedded in the assumptions. Section IV presents the results and potential impact on investors at various age and income levels, the implications for retirement security and an estimate of total potential investor losses due the Proposed Rule.

The Compass Lexecon comment finds that an investor who uses a taxable account to generate retirement savings can pay a median effective average tax rate of 30.0%-43.3% (Exhibits A and B, Median Values) compared to 17.1%-25.0% and 15.0%-25.0% for investors using Roth IRA and Traditional IRAs respectively. The ranges in these estimates are driven by uncertainty in the assumptions made—the investor's age, income, tax rates, asset allocation, returns, size and frequency of contributions, and age at retirement. The Compass Lexecon comment concludes that about 7.0 million household accounts could be affected and estimates the potential investor losses at between \$147 billion and \$372 billion over what we understand to be a period of roughly 30 years.

## ***Discussion***

### **Overview**

Compass Lexecon uses a model to show that IRA investors can suffer a reduction in retirement savings as a result of the Proposed Rule. This effort hinges on the following line of thinking. The DOL's Proposed Rule will cause investors who use a commission-based IRA account to move to a fee-based account. But "participants in this rulemaking have stated that, if subjected to the changes in fiduciary status imposed by the proposed amendments, firms currently offering commission-based IRAs will no longer find it cost-effective to offer IRAs to small account holders, such as those with a balance below \$25,000" (Compass Lexecon 2015, p. 1). However, taxable savings plans, which are not affected by the Proposed Rule, will be available

to these investors as an alternative mechanism to fund their retirement. If an investor, unable to gain access to a commission-based IRA account and the assistance that comes with one, instead chooses to start a taxable savings account, he or she stands to lose a large portion of retirement savings to taxes every year.

Compass Lexecon attempts to quantify the impact on retirement savings, *if* investors use taxable savings accounts instead of IRA accounts. Little to no attention is devoted to how likely investors are to use taxable accounts to fund retirement. Whether the severity of the problem that Compass Lexecon seeks to highlight equates to a mountain or a molehill depends heavily on the propensity of investors to start using taxable accounts to fund retirement savings.

The remainder of this section focuses on the likelihood of investors, who by assumption cannot avail themselves of a commission-based IRA account, would instead choose to open a taxable savings account.

### **Likelihood of Investors Using Taxable Savings Accounts to Save for Retirement**

The Compass Lexecon comment operates under the premise that some brokerage investors may consider using a taxable savings account to fund their retirement: “the proposed amendments have the potential to affect all households that (absent the amendments) would have started brokerage IRAs either from a contribution or a rollover of less than \$25,000” (Compass Lexecon 2015, p. 19.).

But the comment does not consider current and future options available to IRA investors who want to gain or preserve access to an adviser account arrangement. We have discussed multiple options available to IRA investors seeking to preserve access to financial advice such as ‘robo’ advice, target-date mutual funds and hybrid investment advice that combines automated and human-based investment advice. These options are discussed in detail in Section 2.

The presence of existing options for investment advice as well as the possibility of new options suggest that new and existing IRA investors are not likely to sacrifice valuable tax benefits to preserve access to human-based investment advice.

### **Benefits of Tax Sheltering**

To demonstrate and measure the effect of tax sheltering, Compass Lexecon developed a model that used multiple inputs and made numerous assumptions to conclude that investors in taxable savings accounts would experience lower savings at retirement. To address uncertainty in the assumptions, Compass Lexecon evaluated multiple scenarios to estimate that “at the time of retirement, taxable saving accounts have a value that is between 11.1 percent and 21.9 percent lower than Roth IRAs, and between 18.2 percent and 28.1 percent lower than traditional IRAs” (Compass Lexecon 2015, pp. 19-20). This reduction was applied to an estimated \$1,323 billion in IRA savings to arrive at potential investor losses ranging from \$147 billion to \$372 billion by the time investors reach age 65.

We agree that investors in taxable savings accounts will experience reduced rates of savings. However, the estimated \$1,323 billion in IRA savings at retirement is inflated.

To arrive at this estimate, Compass Lexecon assumes that half of the estimated 14.0 million IRAs currently in a brokerage setting would not have \$25,000 when opening an IRA, but would open a taxable account instead. These accounts are then assumed to grow and reach the overall IRA average at age 65 of \$188,976 (in 2013 dollars). But because these affected accounts had low assets (less than \$25,000) when they were assumed to start, they are unlikely to reach the IRA average at retirement. The assumption that accounts with low balances will somehow reach average account balances at retirement is unreasonable and inflates the measure of potential effect on savings. Moreover, the total potential investor losses that Compass Lexecon calculates are accrued over 30 to 40 years of investment and have to be divided appropriately to arrive at an annual measure.

The reduced savings between IRAs and taxable accounts is also driven by the tax rates paid by investors during retirement. Tax rates are applied on anticipated retirement income. Compass Lexecon assumes that investors will experience a reduction in income of 40% upon retirement. This assumption is based on findings from a 1997 working paper and a 2008 publication from the Social Security Administration (Biggs and Springstead 2008). Using the latter source, Compass Lexecon states that the replacement rate, expressed as retirement income as a percentage of preretirement earnings, is 69% and 52% for median households in the 3<sup>rd</sup> and 4<sup>th</sup> highest lifetime earnings quintiles respectively. However, these statistics measure the replacement rate from income from shared Social Security benefits only, rather than from total household retirement income from all sources. If these additional sources of income are accounted for, it will increase Compass Lexecon's income and tax rate assumptions for IRA investors and thus reduce the benefits of tax sheltering.



## 7. LITAN AND SINGER

### *Summary*

In response to DOL's Proposed Rule, the Capital Group submitted a report by Robert Litan and Hal Singer of Economists, Inc. titled "Good Intentions Gone Wrong: The Yet-To-Be Recognized Costs of the Department of Labor's Proposed Fiduciary Rule" (Litan and Singer, 2015a). In response to questions from the DOL, Litan and Singer provided additional details in a letter (Litan and Singer, 2015b). This section contains a review of the Litan and Singer study and letter.

Litan and Singer assert that DOL's Proposed Rule would result in a reduction in financial advisory services, particularly for individuals with modest investment portfolios, and in cost increases for other investors who migrate from brokerage to advisory accounts. They further assert that the requirements of the Best Interest Contract Exemption are so onerous that "it is unlikely that many brokers will seek an exemption." Consequently, the study claims that some investors would be left without financial advice, which would result in poorer financial decisions.

Litan and Singer do not provide, or cite, empirical analysis supporting their premises. The financial industry, renowned for its ability to innovate and evolve, is likely to adapt to new regulation through modified account types. Low-cost "robo" advice options, which are especially suitable for small accounts that do not need much advice, are already increasingly available, including for very small accounts. Also, investors may turn elsewhere for advice. Even apart from corrections discussed below, Litan and Singer's study could be viewed as a "what-if" exercise based on unsupported assumptions.

The study faults DOL for not including the impacts of reduced financial advice and proceeds to estimate that the loss of financial advice would reduce the annual returns of investors with modest portfolios by 44.5 bps and increase the costs of investors migrating to advisory accounts by 31 bps. These estimates of the "yet-to-be recognized costs" exceed Litan and Singer's 25 bps restatement of DOL's estimate of the Proposed Rule's benefits of reducing conflicted advice. The study also claims that (1) DOL's application of results from academic studies in estimating the gains from less conflicted advice substantially overstates the gains, (2) a simple disclosure statement would be a more cost-effective alternative for reducing conflicted advice, and (3) DOL has not produced real-world empirical support for its rejection of greater disclosure requirements.

DOL's Regulatory Impact Analysis (RIA) predicts that the Proposed Rule can generate approximately \$40 billion over 10 years in additional investment returns. Litan and Singer restate this amount as what they claim to be an equivalent annual return increase of 25 bps. In performing this translation, Litan and Singer incorrectly divide the *discounted* 10-year benefit by an *undiscounted* asset base, which has the effect of understating the benefit. Correcting this error lifts the equivalent annual return boost from reduced conflicts of interest estimated in the RIA from 25 bps to 36 bps.

Litan and Singer heavily rely on what appears to be a Vanguard training or marketing document to estimate the 44.5 bps loss in annual return they attribute to reduced financial advice. The validity of this estimate depends on (1) whether

Vanguard's results—which are based on non-conflicted advice—apply to conflicted advice, (2) whether there are costs associated with financial advice that are not accounted for in Vanguard's results, (3) whether there is double-counting among separate components of purported negative impacts, and (4) small investors' proportion of the asset base of IRA investments in funds with front-end loads (upon which the RIA's estimated impacts are based). Even if the Vanguard results are accepted as valid and applicable, correcting double-counting and other errors and weighting by the proportion of assets held by investors with modest portfolios would reduce the estimated benefit of financial advice from 44.5 bps to 2 to 3 bps. Even that effect assumes that the value that Vanguard attributes to its non-conflicted advice applies equally to conflicted advice. Similarly, Litan and Singer's estimate of a 31 bps cost for investors migrating to advisory accounts is overstated, as it relies on the flawed Oliver Wyman (2011) study that excluded costs and did not account for the fact that current brokerage investors tend to be less costly to serve. Also see Section 2. Table 5 summarizes Litan and Singer's estimates of gains and losses from the Proposed Rule and their corrected values. Instead of a net loss of 8 bps as projected by Litan and Singer, our corrections suggest a net gain of 33 bps.

**Table 5. Summary of Litan and Singer Estimates and Their Corrected Values**

	Litan and Singer		Corrected	
	Estimate (bps)	Asset- weighted* (bps)	Estimate (bps)	Asset- weighted* (bps)
Benefit from reduced conflicts of interest (all IRAs)	25	25	36	36
Loss from increased market timing and less portfolio rebalancing (modest IRAs)	-44.5	-6.675	-17.5	-2.625
Higher fees in advisory accounts (high-balance IRAs)	-31	-26.35	0	0
Net gain from Proposed Rule		-8.025		33.375

\*Assumes that 10%-20% of assets are in IRAs with modest balances and the remainder in high-balance IRAs; see the text. This table applies a weight of 15% for modest- and 85% for high-balance IRAs.

Litan and Singer also challenge DOL's calculations of the cost of conflicted advice, asserting that the DOL misapplied or misinterpreted academic studies. Litan and Singer offer no empirical support for the validity or magnitude of their specific criticisms, which are generally undermined by a careful reading of the academic literature upon which DOL relied.

Finally, Litan and Singer attempt to support their alternative disclosure proposal with an academic article that deals with factors that mitigate, but not necessarily eliminate, the harmful effects of conflicted advice. Based upon a review of that article, we conclude that it does not support that Litan and Singer's proposed alternative would eliminate the effects of conflicted advice. In fact, the authors of that article explicitly argue for decreasing conflicts of interest rather than disclosing them.

## ***Synopsis***

Litan and Singer assert that (1) DOL's Proposed Rule would result in a reduction in financial advisory services for individuals with modest investment portfolios and cost increases for investors migrating from brokerage to advisory accounts and (2) the requirements of the Best Interest Contract Exemptions are so onerous that "it is unlikely that many brokers will seek an exemption." Consequently, the study claims that many investors would be left without financial advice, which would result in poorer financial decisions. The study faults the DOL for not including the impacts of reduced financial advice and proceeds with its own quantitative estimates of the monetary impact of a loss of financial advice. The study claims that these "yet-to-be recognized costs" exceed the benefits from reducing conflicted advice estimated by DOL.

Litan and Singer's quantitative estimates include the following:

- Based on the premise that many investors would lose access to advice and on Vanguard (2014a), Litan and Singer produce estimates of the loss in benefits from financial advice. The study calculated an impact of 27 bps for advising investors to avoid market timing and 17.5 bps for more portfolio rebalancing, for a total impact of 44.5 bps.
- Based on a single, hypothetical example presented by Oliver Wyman (2011, p. 23), Litan and Singer apply an annual estimate of a 31 bps increased cost to all investors who would migrate to advisory accounts.
- Scenario 1 of DOL's RIA predicts that the Proposed Rule will generate approximately \$40 billion over 10 years in additional investment returns. Litan and Singer convert this benefit into an annual percentage by subtracting \$240 million in annual compliance costs and dividing over the average investment base of \$1.487 trillion that the study calculates from data presented in the RIA.
- Because the resulting gain of about 25 bps from reduced conflicted advice is less than the 44.5 bps lost from reduced financial advice and the 31 bps increase in costs from migrating to advisory accounts, the study concludes that the costs of the Proposed Rule exceed the benefits.

The study also claims that (1) DOL's application of results from academic studies in estimating the gains from less conflicted advice substantially overstates the gains, (2) a simple disclosure statement would be a more cost-effective alternative for reducing conflicted advice, and (3) DOL has not produced real world empirical support for its rejection of greater disclosure requirements.

## ***Discussion***

### **Litan and Singer's Primary Estimates**

Litan and Singer argue that the Proposed Rule would cause financial advisers to provide less advice, particularly to investors with smaller balances. A major focus of their study is a comparison of the magnitude of the benefits from reducing conflicted advice presented in DOL's RIA with the benefits that according to Litan and Singer would be foregone due to reduced advice. Litan and Singer followed these steps in carrying out the comparison: (1) translate the 10-year gains from DOL's first scenario (\$39.8 billion; RIA, Table 3.3.1-1) into an average increase in annual return

on investment and (2) use estimates from what appears to be a Vanguard training or marketing document (Vanguard 2014a) to produce estimates of what Litan and Singer offer as the loss in annual return from investors receiving less advice with regard to market timing and portfolio rebalancing. The study estimates that loss of advice would result in a reduction in annual returns that exceeds the gain that the Litan and Singer's translation of DOL's first scenario's benefits produced.

### **Translating DOL's 10-Year Gains into an Increase in Average Annual Return**

Litan and Singer's calculation (1) starts with DOL's 10-year gain of \$39.8 billion; (2) divides this amount by 10 to produce an average annual gain that the study rounds to \$4 billion; (3) reduces this amount by DOL's estimated annual implementation costs of \$0.24 billion, producing annual net benefits of \$3.76 billion; and (4) divides the average annual net benefits by the study's estimate of \$1,487 billion for the average 10-year investment base, resulting in a gain of 25 bps.<sup>51</sup>

Because the numerator of their calculation starts with *discounted* 10-year benefits,<sup>52</sup> but the denominator—average asset base—is stated in nominal dollars, Litan and Singer's translation of DOL's 10-year impact into a basis-point equivalent understates the effect on average annual return. One way to correct the study's improper mixing of real dollars in the numerator with nominal dollars in the denominator is the following calculation: (1) for each of the 10 years in DOL's 10-year scenario, calculate an annual increase in return as the change in asset differential (row F) less implementation cost of \$0.24 billion divided by the average of the beginning and ending assets (rows C and E) and (2) calculate the 10-year average of these increases. The result of this calculation is a gain of 36 bps.<sup>53</sup>

---

<sup>51</sup>  $(4.00 - 0.24) / 1,487 = 0.25\%$ . The study, which does not provide details on how the 10-year average investment base was calculated, appears to have used data in Table 3.4.2-1 of the RIA. We calculated an average investment base of 1,496 billion, using rows (B) and (D)—beginning- and end-of-year baseline front-end load mutual fund assets. Adding to this uncertainty, the study estimates the investment base to be \$1.478 trillion on page 1 and \$1.487 trillion elsewhere.

<sup>52</sup> The RIA describes the calculation of a discounted (or real) 10-year gain as follows (DOL 2015a, p. 117):

The asset differential at the end of the 10-year period (2025, Row H) together with the portion of the asset differential withdrawn in each year (Row G) makes up the 10-year quantified subset of IRA investors' expected gains under alternative scenarios 1. However, before those numbers are summed, they are each discounted by the appropriate number of years at a rate of 5.3 percent (Rows I and J) so that the 10-year front-load-mutual-fund-gain-to-investors is expressed in January 1, 2016 dollars.

<sup>53</sup> The annual returns we calculate appear to match those described by Litan and Singer (p. 7): "Table 3.4.1-1 of the RIA suggests that its calculated improved performance differential, which starts out at 10 basis points, eventually will grow to 51 basis points in 10 years, as currently held IRA and defined contribution funds move to better performing funds." Litan and Singer are most likely describing Table 3.4.2-1, not Table 3.4.1-1. We matched the beginning and ending values of 10 and 51 bps. Unlike Litan and Singer's calculation of a 25 bps effect, these annual returns (as well as the average of the annual returns) do not suffer from the bias due to mixing real and nominal dollars.

## Losses Due to Reduced Financial Advice

Litan and Singer's estimate that the loss of financial advice would result in a 44.5 bps reduction in annual return consists of two components: a 27 bps loss due to market timing and a 17.5 bps loss due to portfolio rebalancing. Both components are back-of-the-envelope estimates, as described next.

For the market timing estimate, Litan and Singer rely on a Vanguard comparison of the performance of self-directed investors (for which Vanguard and Litan and Singer assumed there was no advice with regard to market timing) with performance of Vanguard's Target Retirement Funds over the five years ending on December 31, 2012. Litan and Singer (2015a, p. 17) report that Vanguard's comparison indicated that 27% of self-directed investors made at least one exchange of money between funds or into other funds and had returns averaging 150 bps lower than those of Target Retirement Funds. In contrast, Litan and Singer indicate the 73% of self-directed investors who did not exchange money (and who by definition did not attempt to time the market) underperformed Target Retirement Funds by 19 bps.<sup>54</sup> Litan and Singer (1) calculate the weighted average of the underperformance of these two groups relative to Target Retirement Funds ( $0.27 \times 150 + 0.73 \times 19 = 54$  bps); (2) assume that the maximum effect of advice that results in avoidance of market timing was this weighed average, while the minimum effect was zero; and (3) pick the mid-point of this assumed range—27 bps—to represent the estimated impact of lost financial advice.

Litan and Singer's use of this estimate as the impact of reduced financial advice is consistent with the *assumptions* that (1) investors currently receiving advice realize returns that approximate the performance of the Vanguard target date funds, i.e., among other things, they do not engage in market timing; (2) reduced financial advice would result in investors who own  $27\%/2 = 13.5\%$  of the assets of investors no longer receiving advice making poor timing decisions; and (3) for those investors who previously did not need advice to avoid market timing, reduced financial advice on avoiding market timing would result in investors holding  $73\%/2 = 36.5\%$  of assets somehow earning a slightly lower return than they formerly did.

For the portfolio rebalancing estimate, Litan and Singer base their estimates on Vanguard's comparison of the average annual return of a portfolio with 60% stocks and 40% bonds that was not rebalanced over the 53-year period from 1960 to 2013 with the return of a rebalanced portfolio with 80% stocks and 20% bonds. The latter portfolio had about the same risk as the former portfolio, but an average annual return that was 35 bps higher. Litan and Singer's estimate of the effect of reduced advice (1) at least implicitly assumes that Vanguard's comparison of two stylized portfolios is representative of the effect of rebalancing, independent of portfolios that investors actually hold; (2) assumes that the maximum effect of advice that results in better balanced portfolios was the 35 bps spread in the Vanguard comparison, while the minimum effect was zero; and (3) picked the mid-point of this assumed range—17.5 bps—to represent the estimated impact of lost financial advice. Litan and Singer's use of that estimate as the impact of reduced financial advice is consistent with the *assumptions* that (1) investors currently receiving advice realized

---

<sup>54</sup> We were unable to find the specific percentages in Vanguard (2014, p. 16). In particular, Vanguard's document indicates that "a majority of investor returns trailed their target-date fund benchmark slightly." While the majority Vanguard describes could be 73%, that specific percentage does not appear in Vanguard (2014).

returns that approximated the performance of Vanguard's balanced portfolio and (2) lost financial advice would result in investors owning 50% of the assets of investors who would lose advice no longer optimally rebalancing.

## Losses from Migrating to Advisory Accounts

Litan and Singer assume that some investors will suffer a 31 bps cost increase associated with migrating from brokerage to advisor accounts. This estimate is based on converting Oliver Wyman's (2011, p. 23) single, tersely explained hypothetical example into a number that presumably applies across-the-board to all investors assumed to migrate. In particular, with a minimal amount of detail, Oliver Wyman calculate that a hypothetical 40-year old saver who invested \$25,000 up-front and \$4,000 annually would have 8 percent more savings at age 65 in a brokerage account. That difference, in turn, is equivalent to an annual 31 bps difference.<sup>55</sup> Therefore, Litan and Singer's *assumption* is that Oliver Wyman's hypothetical example, complete with the excluded costs we described in Section 2 and its static view of the financial industry, provides a reliable estimate of cost increases certain investors could experience.

## Evaluation of Litan and Singer's Primary Results

There are several considerations in evaluating the validity of Litan and Singer's primary conclusion—that the 44.5 bps reduction in returns it claims would result from less financial advice and the 31 bps cost from migrating to advisory accounts exceed the 25 basis point gain from less conflicted advice they calculate from DOL's first scenario. These include: (1) the applicable asset base for increases or decreases in annual returns posited by DOL and Litan and Singer; (2) the plausibility of the assumptions Litan and Singer used in applying Vanguard's estimates; (3) whether there are any costs to provide financial advice that are not reflected in Vanguard's examples; and (4) whether Litan and Singer's separately estimated items—market timing and portfolio rebalancing—overlap, i.e., whether the sum of estimates double count some benefits. We discuss these four issues in turn.

With regard to asset base, in order to be informative, Litan and Singer's comparison of their translation of DOL's investor gains and their estimate of annual returns losses from reduced advice would have to address the same asset base. In particular, DOL's analysis related to front-end mutual fund assets, which in principle could include the accounts of investors of various sizes from small investors to much larger investors. In contrast, Litan and Singer appear to limit the potential harms from less financial advice to investors of modest means, e.g., "savers with modest portfolios" (Litan and Singer 2015a, p. 12) and/or "middle-income savers" (Litan and Singer 2015a, p. 16). Litan and Singer provide no information on the asset base of those investors who they believe would lose investment advice if the proposed rule were implemented. While such investors may account for a substantial share of the *accounts*, they account for a much smaller proportion of total assets in front-end load mutual funds. For example, data provided in NERA (2015a, 2015b) suggest that accounts with balances of \$100,000 or less—a threshold that is even higher than the level at which some commenters speculate that investors will lose financial advice—

---

<sup>55</sup>  $31 \text{ bps} = \sqrt[25]{1 + 0.08} - 1.$

hold about 12% of assets.<sup>56</sup> In other words, the presumed 44.5 bps impact applies to just 12% of assets. Conversely, the asset base that would apply to the smaller of Litan and Singer's assumed impacts—increased costs from migrating to advisory accounts—would be to the remainder of current brokerage account investors, i.e., on the order of 80% to 90%.<sup>57</sup>

Turning to Litan and Singer's assumptions, for both components they assume (at least implicitly) that (1) the Vanguard examples—Target Retirement Funds in the case of market timing and a stylized balanced portfolio in the case of rebalancing—are representative of the results currently obtained by investors receiving advice and (2) the reduction of advice would result in investors who account for half the asset base making less favorable investment decisions. Litan and Singer do not provide empirical support for either of these assumptions. In addition, because Vanguard (2014a) describes its results as "Vanguard quantifies the value-added of *best practices* in wealth management", even if the Vanguard estimates were representative of the gains from good financial advice, they would be valid only to the extent that all advisers whose services were potentially lost as a result of the Proposed Rule were performing at a best-practices level.<sup>58</sup> Specifically, Vanguard's advisory services render non-conflicted advice. Litan and Singer attribute the benefits that Vanguard claims for non-conflicted advice to conflicted advice and simply assume away the difference that is the motivation for the proposed regulation.

Further, even if these assumptions were reasonable, the impact for market timing would be overstated because Litan and Singer included the 19 bps difference of self-directed investors who did *not* engage in any market transactions, and by definition could not have been talked out of inadvisable investment, as part of the overall effect. Indeed, Vanguard (2014a) did not appear to view the 19 bps differential as being associated with advice: "The result was that a majority of investor returns trailed their target-date funds slightly, which might be expected based on the funds' expense ratios alone." Seen in this light, rather than being a gain from financial advice, the difference between the 150 bps differential for the investors with transactions and the 19 bps differential for those without transactions, or 131 bps, is the best measure of the impact of market timing implied by Vanguard's results. Correcting Litan and Singer's calculations would (1) reduce the upper bound from 54 bps to 35 bps ( $0.27 \times 131$ ) and (2) reduce the mid-point of the range from 27 bps to 17.5 bps.

With regard to possible excluded costs associated with financial advice, in describing the benefits from rebalancing Vanguard (2014a, p. 15) notes:

---

<sup>56</sup> Similarly, Panis and Brien (2016) show that about 10% of IRA assets are owned by households with IRA assets under \$100,000. ICI (2015a, p. 28) reports a higher percentage—approximately 19%.

<sup>57</sup> Litan and Singer (2015, pp. 2-4) present a range that is equivalent to a maximum impact of 44.5 bps (everyone losing advice) to a minimum of 31 bps (everyone migrating to brokerage accounts).

<sup>58</sup> Vanguard's description is consistent with this interpretation: "This paper takes the Advisor's Alpha Framework further by attempting to quantify the benefits that advisors can add *relative to others who are not using such strategies*" (Vanguard 2014, p. 1, emphasis added).

Keep in mind, too, that rebalancing is not necessarily free: There are costs associated with any rebalancing strategy, including taxes and transaction costs, as well as time and labor on the part of advisors. These costs could all potentially reduce your client's return.

Litan and Singer's use of Vanguard's example, without accounting for the additional costs that Vanguard noted, results in an overstatement of possible benefits associated with rebalancing. Further, Vanguard's observation appears to be especially germane to front-end load mutual funds, for which rebalancing would impose relatively high transaction costs.<sup>59</sup>

Finally, with regard to double-counting, the fact that rebalancing is a feature of the Target Retirement Funds Vanguard used to measure the impact of market timing implies that the differential in returns between the target date funds and self-directed investors would capture the effects of both rebalancing and market timing.<sup>60</sup> Accordingly, as described earlier, to the extent that Vanguard's comparisons are representative of the value of financial advice, the difference between the 150 bps differential between self-directed investors who had market transactions and target retirement funds and the corresponding 19 bps differential for those who had no transactions, or 131 bps, would remove the double-counting with rebalancing. Further, the fact that, as Vanguard explained, the 19 bps differential for the latter group may be explained by expense ratios alone suggests that the benefits from rebalancing may be very small.

In summary, Litan and Singer's bottom line conclusion that the Proposed Rule will lead to a reduction of financial advice that in turn will cost investors more than the benefits DOL estimates would be realized from less conflicted advice is incorrect because (1) Litan and Singer's translation of DOL's investor gains into a basis-point equivalent is incorrectly too low because the estimate improperly mixes real

---

<sup>59</sup> Litan and Singer (2015a, p. 17) claim that brokers have an opposite incentive to keep investors in the market so that growing portfolios will produce greater 12b-1 fees. They do not analyze whether the incentive they posit is sufficiently strong to dissuade brokers from advising trades that would produce front-end load shares.

<sup>60</sup> In their letter to DOL, Litan and Singer (2015b, p. 3) attempt to explain away the double-counting issue as follows:

Mr. Piacentini's fourth criticism is that Vanguard's estimate of the value of portfolio rebalancing reflects some "double-counting" because such rebalancing is already reflected in the performance of the target date funds. In fact, Vanguard's 2014 study makes very clear that its market timing and portfolio rebalancing estimates are different, and the methods used to derive those estimates are also very different.

The fact that Vanguard discussed what it labeled as "best practices" as separate modules and/or used different methods to derive its results says nothing about whether the separate estimates double-count the effects of advice on performance. Litan and Singer's explanation is analogous to a situation in which both rebalancing advice and market timing advice affect returns linearly and a study presents separate simple regression models for each effect. Since some advisors are likely to provide both kinds of advice, the regression coefficient in each model would include the combined effect of both.



estimated gains with a nominal asset base; (2) the asset base to which estimated losses from less financial advice should be applied is a small percentage of the assets held by current brokerage account investors; (3) Litan and Singer incorrectly applied Vanguard's estimates of the value of advice, which related to non-conflicted advice, to conflicted advice; and (4) even if Vanguard's examples of the benefits from financial advice were representative, Litan and Singer's calculations contain errors such as including the differential returns of investors who did not engage in market timing in the estimated effects of market timing and double-counting the effects of market timing and portfolio rebalancing. If Vanguard's examples are informative, the effect of correcting Litan and Singer's errors would be (1) an increase in the gains from DOL's first scenario from 25 bps to 36 bps, (2) elimination of the separate 17.5 bps loss associated with less rebalancing advice, (3) reduction in the loss associated with less advice on avoiding market timing from 27 bps to 17.5 bps, and (4) application of that impact to an asset base no more than 10% to 20% of what DOL calculated, which (5) would result in an impact of about 2 to 3 bps.

Finally, Oliver Wyman's flawed hypothetical example provides no basis for any additional impact associated with putatively higher costs for the remaining investors assumed to migrate to advisory accounts. Also see our discussion of cost differences between brokerage and advisory accounts in Section 2.

## Benefits of the Proposed Rule

Litan and Singer briefly criticize DOL's estimate of the benefits from ameliorating conflicted advice, which they routinely characterize as a 25 bps impact. Perhaps as a tacit recognition that their criticisms are rather perfunctory, the authors conclude (Litan and Singer 2015a, p. 23):

[T]he purported 25 basis point gain from the rule claimed by DOL is overstated, most likely by a significant degree. Because the estimated costs of the rule are significantly larger than the purported benefits, there is no need for us to discount the DOL's benefits [...]"

As we now explain, Litan and Singer's criticisms do not undermine the validity of DOL's estimated benefits.

Litan and Singer's criticisms that take issue with DOL's interpretation of such academic studies as Christoffersen et al. (2013) and Bergstresser et al. (2009) overlap those of other parties. For example, NERA (2015a) and ICI (2015a) claim that the age of the data in the academic studies undermines their usefulness, and Berkowitz et al. (2015) claim that the results of Christoffersen et al. (2013) are questionable because their models have low R-squares. The first criticism is misguided, among others because the estimated incentive effects of conflicted compensation are not affected by (declining) average load payments; also see the discussion in Section 2. If anything, ICI (2015c) find that the incentives were sharper in more recent data. The second criticism is similarly misguided, in part because predictors of rates of return are generally elusive and it is therefore noteworthy that conflicted payments had a statistically significant effect on rates of return; see Panis (2015).

Litan and Singer offer three additional criticisms: (1) Christoffersen et al. (2013) suffers from the "fundamental oversight" of estimating underperformance only for the year in which a fund is purchased and of not estimating underperformance "during all the years for which the fund is held," (2) the DOL's overall conclusion on

the negative effects of conflicted advice drawn from Bergstresser et al. (2009) is not consistent with the study's finding that foreign equity funds sold by brokers outperformed foreign equity funds sold through direct channels, and (3) that the "RIA also errs by focusing on the average performance of *funds* rather than of *investors in funds*." None of these criticisms have merit.

First, Litan and Singer's assertion that Christoffersen et al.'s measurement of performance as the forward-looking return for the year following the month in which payments to brokers are observed "does not permit reliable conclusions [...] about any annualized under-performance of funds associated with conflicted advice over the long-run" is at best unhelpful because the authors do not provide an alternative approach that would ameliorate possible problems with Christoffersen et al.'s approach. Absent a well articulated alternative approach, Litan and Singer do not provide the information to determine whether this vague concern has any theoretical, let alone practical, merit. More fundamentally, their concern about long-run performance is misplaced, because the forward-looking return measured at any particular point in time pertains to assets invested not only in the month in question, but also to assets bought (and held) earlier.<sup>61</sup> That is, the return measured by Christoffersen et al. *does* reflect the long-run performance of these earlier-purchased assets.

Second, Litan and Singer's implication that Bergstresser et al.'s finding on the performance of foreign equity funds sold by brokers somehow invalidates DOL's conclusions about conflicted advice overlooks both Bergstresser et al.'s observation that the foreign equity result was hardly typical of their overall findings—"The contrary results in the foreign equity funds are attributable to a single fund complex"—and the authors' subsequent conclusion that "summing up across broad equity, bond, and *foreign equity* investment categories leads us to estimate the annual underperformance of the broker-sold funds at \$4.6 billion in 2004" (Bergstresser et al., 2009, p. 4141, emphasis added).<sup>62</sup>

Third, while Litan and Singer suggest that a study of investors, rather than funds, could produce results that differ from conclusions drawn from academic studies of fund performance, they provide no empirical evidence to determine whether their concern is of any practical (as opposed to theoretical) importance, or whether the results would become stronger or weaker. In fact, our analysis of information from NERA's investor-level data presented in Section 3 indicates that consistent with the academic studies, the risk-adjusted returns to investors in commission-based accounts lag behind the returns to investors in fee-based accounts.

### **Litan and Singer's Alternative Disclosure Proposal**

Litan and Singer recommend that disclosing the details of how brokers are compensated with a share of a front-end load and ongoing 12b-1 distribution charges is "a more direct and far less costly alternative" to the Proposed Rule. Litan and Singer fault the DOL for relying on a single article by Loewenstein, Cain, and Sah (2011) to conclude that disclosure alone would be insufficient to remedy the harms from conflicted advice. Apparently, they considered that level of support not strong enough to rule out the efficacy of disclosure. Nonetheless, Litan and Singer cite a

---

<sup>61</sup> The RIA discusses this phenomenon.

<sup>62</sup> Broker sold funds had a 2004 asset base of \$2.6 trillion, implying a reduction in annual return of 179 basis points (Bergstresser et al., 2009, p. 4136, Table 2).

later article by the same authors (Sah, Loewenstein, and Cain, 2013) as support for the efficacy of their recommended disclosure statement (Litan and Singer 2015a, pp. 26-27):

Yet in subsequent research the very same authors identify conditions under which the burden of disclosure is ameliorated: [...] Three out of four of these conditions would seem to apply to the disclosure remedy proposed above: The disclosure would come from an external source (the Department); the advisee would presumably have the opportunity to change her mind (reinvest her assets) at any point in time; and, the advisee would presumably be able to make the decision in private. Therefore, the disclosure requirements suggested above are consistent with recommendations of the very researchers on which the Department relies.

The factors listed by Sah et al. (2013) appear to *lessen*, but not eliminate, the “burden of disclosure.” The burden of disclosure arises when the knowledge that an option that is generally understood to be inferior benefits the adviser at the expense of the advisee actually results in advisees selecting the inferior option more frequently than do advisees who are also advised to select the inferior option, but do not know that the adviser benefits from that choice. For example, while a smaller percentage of advisees selected the inferior alternative recommended by a conflicted adviser when their decision was private, that percentage was still substantially larger than the corresponding advisees to whom the conflict in interest was not disclosed. Further, Sah et al.’s study provides information on both the superior alternative and the inferior alternative that benefits the conflicted adviser; in contrast, Litan and Singer’s recommended disclosure statement would describe only the alternative that advantages the conflicted financial adviser. Finally, after reviewing the results of their study as well as related research, Sah et al. (2013, p. 302) conclude:

[T]he optimal solution to COIs [conflicts of interest] is to eliminate them wherever possible, or at least to increase the availability of unbiased advice [...]. The limits of disclosure revealed by these studies and others suggest that policy makers should focus less on disclosing COIs and more on decreasing them.

## 8. QUANTRIA STRATEGIES

### *Summary*

In response to DOL's Proposed Rule and on behalf of a group of clients, Davis & Harman LLP submitted comments including a study by Quantria Strategies LLC titled "Unintended Consequences: Potential of the DOL Regulations to Reduce Financial Advice and Erode Retirement Readiness" (Quantria 2015). This section contains a review of the Quantria study.

Quantria makes dire predictions about the effects of the Proposed Rule on aggregate retirement outcomes, small businesses, IRA owners, and retirement plan participants. It makes strong assumptions about industry responses. For example, it assumes that financial advisers cannot accept the risk of fiduciary liability and will instead cease to provide advice. The Quantria prediction seems to conflict with the fact that many advisers currently already operate under a fiduciary duty, oftentimes in combination with a lighter standard for some of their other activities.

Quantria assumes that, deprived of financial advice, small businesses will reduce sponsorship of retirement plans and that individuals will increase pension cash-outs, reduce retirement contributions, and commit more investment errors. The benefits that Quantria ascribes to financial advice are based on its persistent confusion of conflicted and non-conflicted advice. While we agree that conflicted advice can confer benefits, overwhelming evidence indicates that they are much smaller than the benefits of non-conflicted advice. Separately, Quantria ignores the possibility that non-conflicted advice could reduce unscrupulous sales practices and root out excessively expensive products. Quantria does not provide any evidence to contradict the possibility that as a result of less conflicted advice, some small business—that currently do not sponsor a retirement plan because of concerns over ulterior motives of their adviser—may start sponsoring a plan.

In short, Quantria relies on unsupported assertions and flawed studies for many of its predictions. Its assumptions about responses by the financial services industry, small businesses, and individuals are unrealistic. As a result, its aggregate estimates of the effects of the Proposed Rule are also unrealistic.

### *Synopsis*

The Quantria study consists of two main parts. The first part discusses unintended effects that Quantria anticipates if the Proposed Rule were implemented as proposed. Quantria argues that the regulation would reduce financial assistance to DC plan participants, owners of small IRAs, and small businesses that may wish to sponsor a retirement plan. Quantria also anticipates a reduction in retirement readiness, i.e., a reduction in such metrics as the fraction of people with sufficient retirement income to cover average expenses and uninsured health care costs (including long-term care costs) at age 65 or older throughout retirement. The authors explain that individuals with lower financial literacy tend to be less prepared for retirement, and that financial advice can help compensate for lack of financial literacy.

The second part discusses anticipated effects of the regulation on retirement savings in more detail for three distinct groups. First, Quantria expects owners of IRAs with low account balances to lose access to financial advice. It also expects fewer IRAs to open as a result of reduced assistance rolling over DC plan balances into an IRA. Second, it expects retirement sponsorship rates among small businesses to fall because of restrictions on marketing activities and because new plans generally carry low balances and may be considered unprofitable to serve. Third, it expects lower DC plan savings because plan participants would have less access to educational materials, would make more investment errors, would take less advantage of employer matching, and would cash-out their DC account upon job separation more often. All combined, Quantria expects losses of retirement savings of \$68 billion to \$80 billion per year. Translated into retirement readiness, "The re-proposed regulations would jeopardize retirement readiness for 11.9 million IRA and retirement participants. This 11.9 million figure consists of individuals who either are unlikely to be retirement ready (6.1 million) or are at risk of failing to be retirement ready (an additional 5.8 million)" (Quantria 2015, p. 32).

## ***Discussion***

### **Overview**

The general applicability of the Quantria study hinges on several premises that Quantria adopts. Among these are the following (Quantria 2015, p. 2):

The re-proposed regulations [...] have a general rule that causes many activities of financial advisers to create potential fiduciary liability and they do not provide workable safe harbors in the prohibited transaction exemptions.

And (Quantria 2015, p. 6):

Most importantly, initial indications suggest that very few, if any, financial institutions could satisfy the best interest contract exemption, thereby practically eliminating this exemption.

Quantria offers little or no empirical justification for these assertions. Ultimately, it is an empirical question whether financial institutions will be able to take advantage of prohibited transaction exemptions.

Quantria further asserts the following (Quantria 2015, p. 4):

As a practical matter, financial advisers cannot risk the sanctions imposed if they violate the fiduciary standards, especially the prohibited transaction rules.

Again, Quantria offers little or no empirical justification for this assertion. Many advisers currently operate under a fiduciary standard. In fact, about two-out-of-three advisers already wear two hats, providing financial-planning or portfolio-management services under a fiduciary standard and serving as salespeople of securities, insurance or other products under a lighter duty (Rieker 2015). The assertion is therefore empirically unsupported and inconsistent with current practices.

While the above assertions raise questions, Quantria adopts them as cornerstones of its report. If in fact the forthcoming regulation does provide workable safe harbors in its prohibited transaction exemptions, and if financial advisers in fact are willing to accept fiduciary responsibility, the Quantria study is merely an exercise in hypotheticals.

The remainder of this section parallels the organization of the Quantria study. We first discuss the unintended effects that Quantria anticipates if the Proposed Rule were implemented as proposed (Quantria's Section II). Next we review Quantria's anticipated effects of the regulation on retirement savings (Quantria's Section III).

## **Unintended Effects of the DOL Regulations**

Quantria starts with presenting an overview of the Proposed Rule. With little or no empirical justification, it asserts that the proposed regulations "do not provide workable safe harbors in the prohibited transaction exemptions" (Quantria 2015, p. 2), that "financial advisers cannot risk the sanctions imposed if they violate the fiduciary standards, especially the prohibited transaction rules" (Quantria 2015, p. 4), that "Companies are likely to find that the costs of providing the required information to qualify for the prohibited transaction exemption would exceed the value of getting or retaining a small account" (Quantria 2015, p. 5), and that "initial indications suggest that very few, if any, financial institutions could satisfy the best interest contract exemption" (Quantria 2015, p. 6). Quantria does not specify what these initial indications are or, more generally, what the basis is for its sweeping assertions. At this time, the regulations are not yet in force and it is impossible to tell whether prohibited transaction exemptions will be workable, or whether some advisers will accept fiduciary liability. However, the remainder of Quantria's study hinges on the validity of the above-cited assertions.

Quantria next discusses unintended effects of the Proposed Rule for small businesses, IRA holders, and retirement plan participants.

### ***Small Businesses***

Quantria argues that the "DOL regulations likely would reduce the availability of financial assistance for the owners of small account IRAs and small business retirement plans" (Quantria 2015, p. 6). It explains that "financial institutions typically earn different amounts on the different options that a small business can choose to offer its employees. As a result, financial advisers would not be able to provide services to these types of customers" (Quantria 2015, p. 7). In other words, Quantria laments the reduction of conflicted advice. Indeed, that is precisely the purpose of the Proposed Rule. Quantria builds on its premise that financial advisers will not accept fiduciary liability. However, many financial advisers currently operate under a fiduciary standard, and indeed many who avoid fiduciary duty for some of their work accept it for other work (Rieker 2015).

Financial institutions likely have at least two options. They can stop selling retirement plans or they can adapt the compensation of their sales force or intermediaries. Providers who currently rely on front-end load sharing and opaque pricing to sell expensive products may find that they can no longer compete under the new regime. The remaining plan products will likely be less expensive. Under a non-conflicted compensation model, sales people or intermediaries can continue to provide their advisory services. In fact, they would no longer have an incentive to push expensive products, making it easier for them to earn the trust of small

businesses and other clients. A potential outcome of that development is that small businesses—that no longer need to be watchful for unscrupulous sales practices—become more likely to start a retirement plan.

### ***IRA Owners***

With respect to existing IRAs, Quantria states (Quantria 2015, p. 7):

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

We discuss these options in turn. First, larger accounts may move to an advisory account. Quantria provides no explanation for its assertion that such accounts may involve higher fees. However, it extensively cites from Oliver Wyman (2011), which tabulated higher fees for fee-based than for commission-based accounts. That comparison accounted for direct costs only and excluded marketing and distribution, shareholder services, and other fees not directly paid by investors. In other words, it excluded load sharing and other indirect payments that are made to commission-based advisers and not to fee-based advisers. Second, Quantria argues that smaller accounts would lose access to an adviser. We discussed and cast serious doubt about this scenario in Section 2. Third, IRA owners could cash out their account, presumably to preserve access to advice. This option is inferior to the other options—particularly in light of recent innovations in the delivery of advice and in such products as target date funds (see Section 2). Fourth, IRA assets may be rolled over into another retirement savings account. The consolidation of assets may indeed be beneficial, as the account holder may be offered lower fees.

In support of its arguments, Quantria cites Garber et al. (2015), which was commissioned by the DOL. For example, “This study, released in February 2015, acknowledges that the regulations could have an adverse effect on some portion of IRA investors and that, as a result, some IRA owners would be worse off under the regulations.” Garber et al. (2015) was indeed released in February 2015, before the Proposed Rule of April 2015. At the time Garber and co-authors wrote their report, the provisions of the Proposed Rule were unknown. Their conclusions stem from general thought experiments of potential effects, not from an analysis of the actual Proposed Rule.

### ***Retirement Plan Participants***

Turning to retirement plan participants, Quantria argues that the Proposed Rule would reduce the availability of educational materials for retirement plan participants. It claims that educators would not be allowed to give examples of funds that fit within recommended asset classes. It is our understanding that the Proposed Rule includes a carve-out for educational activities.

Quantria is also concerned that the Proposed Rule would prompt additional cash-outs of DC plans when plan participants terminate their employment. It predicts that their plan’s financial services adviser would stop contacting departing employees because

they would not be allowed to promote their own IRA products. This may not be a bad development, since leaving the assets in the previous employer's plan may be a good option. Current rules require retirement plans to allow terminating employees with balances greater than \$5,000 to stay in the plan (GAO 2014). These employees can continue to enjoy the plan's fiduciary safeguards and access to low-costs funds.

Quantria refers to its 2014 study (Quantria 2014) in which it predicted large increases in cash-outs and large reductions in the lifetime retirement savings as a result of increased cash-outs. Panis (2014) reviewed that study and found it deeply flawed. Among others, Quantria relied on a correlation between financial advice and retirement assets to assert causality, where the causality may in fact go in the reverse direction, and it confused lump sum distributions with cash-outs.

### ***Retirement Readiness***

Having discussed unintended consequences for small businesses, IRA holders, and retirement plan participants, Quantria presents the basis for its empirical analysis of unintended effects of the Proposed Rule for retirement outcomes. It offers several definitions of retirement outcomes and adopts the "retirement readiness" measure defined in VanDerHei (2014): "having adequate retirement income to cover average expenses and uninsured health care costs (including long-term care costs) at age 65 or older throughout retirement" (Quantria 2015, p. 9).

Quantria reviews literature on financial literacy and reports that "individuals who lack financial literacy are less likely to plan for retirement and less likely to demonstrate retirement readiness" (p. 11) and that "African-Americans and Hispanics generally have low levels of financial literacy" (Quantria 2015, p. 11).

Quantria argues that low financial literacy can be countered by financial advice. We agree that this is likely the case, but are not convinced by Quantria's arguments. For example:

- Quantria cites Garber et al. (2015) as stating that unsophisticated investors benefit from time savings by using a financial adviser and also from help in choosing investment products. However, Garber et al. (2015) refer to benefits from non-conflicted advisers.
- Quantria also cites Financial Engines/Aon Hewitt (2014), who document that plan participants who benefit from investing in target-date funds, managed accounts and online advice. Again, these are examples of non-conflicted advice.

In other words, Quantria confuses the benefits of non-conflicted advice with those of conflicted advice.

### **Effects of the Regulations on Overall Retirement Savings**

The next part of the Quantria study attempts to quantify the effects of the Proposed Rule on retirement readiness. As before, the authors separately discuss IRA owners, small businesses, and retirement plan participants. In the final stage, Quantria presents aggregate estimates of the Proposed Rule's anticipated effects on retirement readiness.



### ***IRA Owners***

Quantria presents general statistics on IRA assets and contributions, distinguishing Traditional, SEP, SIMPLE, and Roth IRAs. The authors point out that “individual or small business investors often open multiple IRA accounts over their retirement savings horizon, creating multiple small accounts” (Quantria 2015, p. 17) that they typically do not consolidate. This suggests that some IRA owners with small balances who may lose access to an adviser will be able to avoid this by consolidating their accounts.

Based on several sources, Quantria estimates such inputs to its model as the fraction of IRAs with small balances and the magnitude of inflows from direct contributions and from rollovers.

Along the way, the authors seek to demonstrate that financial advisers or call centers do not play a major role in encouraging departing employees to roll over their retirement plan assets: “The data on the large number of rollovers exceeds the assistance provided to terminating employees” (sic, Quantria 2015, p. 19). This nonsensical statement appears to be based on rollover activity by 4.1 million taxpayers in 2012 and an unspecified (but presumably smaller) number of contacts with terminating employees.

Quantria relies on Oliver Wyman (2011) for estimates on the number of IRA owners who would lose access to financial advice and the reduction in overall IRA savings. A review by Garber et al. (2015) of the Oliver Wyman study demonstrated that its estimates of account costs (also see above) and industry responses are unreliable. We also reject the predictions of Oliver Wyman (2011) as a reliable basis for any estimates of the consequences of the Proposed Rule.

Quantria also cites Garber et al. (2015) to claim that availability of investment advisers serving the IRA market may well decline after the Proposed Rule takes effect. Indeed, Garber et al. raised that theoretical possibility, but also stated that “[e]ven major reductions in numbers of financial advisors serving the IRA market would not necessarily be economically undesirable, however, because the numbers of professional advisors serving the IRA market currently may be too high from an economic efficiency perspective. Much of the current demand for financial services may be attributable to many retail IRA investors overvaluing these services because these investors do not understand the fees they are paying (directly or indirectly) or the associated costs of advisor self-dealing” (Garber et al., 2015, p. 18). Their argument is similar to the one we made above.

### ***Small Businesses***

Quantria presents general statistics on the number of small businesses, the number of people they employ, retirement plan sponsor rates. It relies on a survey by Greenwald and Associates (2014) for estimates of the fraction of small businesses that would stop sponsoring their retirement plan or would reduce employer matches if the Proposed Rule were implemented. The survey describes the Proposed Rule to its respondents in the following language (Greenwald and Associates, 2014, p. 23):

“The Department of Labor is considering prohibiting both retirement plan providers and the advisors who sell retirement plans to employers from assisting the employers in the selection and monitoring of the funds in the retirement plan. Under possible new rules, the employer would have two

options: (a) find an independent expert on investments to provide, for an additional fee, guidance on the selection and monitoring of investment options, or (b) do the selection and monitoring themselves, subject to fiduciary liability if this selection is not done in a prudent manner by someone with sufficient expertise. If “a” is chosen, the plan sponsor would be subject to fiduciary liability if the expert is not chosen in a prudent manner.”

This language is patently false and incendiary. The objective of the Proposed Rule is to improve advice, not to reduce it. The Quantria study provides no reliable empirical evidence to the contrary. A potential outcome of non-conflicted advice is that small businesses—that no longer need to be watchful for unscrupulous sales practices—become more likely to sponsor a retirement plan. Although a survey was performed by Greenwald and Associates on this topic, the survey educated respondents in a biased manner. The Greenwald and Associates survey results, therefore, were biased. We reject the survey as a reliable basis for any estimates of the consequences of the Proposed Rule.

### ***Retirement Plan Participants***

For current plan participants, Quantria states that about 53% of “[r]etirement plans make available educational information to improve financial literacy as well as investment advice to improve the performance of their employees’ retirement plans” (Quantria 2015, p. 25). We agree that such educational information can be beneficial to plan participants. Such assistance is non-conflicted and it is our understanding that the Proposed Rule contains an education carve-out for this purpose.

Quantria also cites Financial Engines/AON Hewitt (2014) and Vanguard (2014b) to argue “that people using managed accounts and online advice have higher average contribution levels than other participants” (Quantria 2015, p. 25). Leaving aside the very likely possibility of reverse causality (people who are serious about retirement are more likely to seek assistance; see Section 2), both studies focus on assistance in the context of DC plans, i.e., this relates to non-conflicted advice. It further cites Financial Engines (2015) as evidence that “participants that use financial advisory services (including both active users of online advice and professional management services) were more likely to maximize their matching contributions” (Quantria 2015, p. 26). Again, this relates to non-conflicted advice. Finally, it argues that DOL (2011) states that “quality advice will address over concentration in employer stock and other failures to properly diversify” (Quantria 2015, p. 27). Again, the DOL (2011) analysis related to (an expansion of) non-conflicted advice.

In short, Quantria repeatedly confuses non-conflicted with conflicted advice. It attributes the benefits of non-conflicted advice to conflicted advice and uses them to estimate the effects of the Proposed Rule. We reject such benefits as a reliable basis for any estimates of the consequences of the Proposed Rule.

For terminating employees, Quantria expects the Proposed Rule to increase retirement plan cash-outs. It confuses gross distributions with cash-outs, as it also did in its earlier study on the subject (Quantria 2014). It states that “42 percent of employees take a cash distribution of their retirement savings at job termination” (Quantria 2015, p. 28) and omits to mention that these cash-outs are overwhelmingly small, accounting for just 7% of dollars (Aon Hewitt 2011). Quantria relies on its 2014 study of cash-outs for estimates of increased cash-outs. As noted above, Panis (2014) reviewed that study and found it deeply flawed. We reject

Quantria (2014) as a reliable basis for any estimates of the consequences of the Proposed Rule.

### ***Retirement Readiness***

Based on various assumptions discussed (and rejected) above, Quantria produces projections of the effects of the Proposed Rule on retirement outcomes: “the regulations could be expected to result in losses of retirement savings of \$68-\$80 billion each year” (Quantria 2015, p. 29) and the “regulations would jeopardize retirement readiness for 11.9 million IRA and retirement participants” (Quantria 2015, p. 32). Of these, roughly one-half are labeled “unlikely” to be retirement ready and the other half “at risk of failing” to be retirement ready.

Quantria provided very little detail that would permit an evaluation of its assumptions and calculations. As discussed in detail above, Quantria’s assumptions on responses by the financial services industry, small businesses, and individuals are unrealistic. As a result, its aggregate estimates of the effects of the Proposed Rule are also unrealistic.

## 9. REFERENCES

- Aon Hewitt. 2011. "Leakage of Participants' DC Assets: How Loans, Withdrawals, and Cashouts Are Eroding Retirement Income 2011." Available at [http://www.aon.com/attachments/thought-leadership/survey\\_asset\\_leakage.pdf](http://www.aon.com/attachments/thought-leadership/survey_asset_leakage.pdf).
- AT Kearney. 2015. "Hype vs. Reality: The Coming Waves of `Robo' Adoption." Available at <https://www.atkearney.com/financial-institutions/robo-advisory-services-study>.
- AXA Equitable Life Insurance Company. 2013. "Retirement Cornerstone Variable Annuity Series: Commissions Paid to Broker/Dealer." Available at [https://us.axa.com/docs/annuity/rc13\\_commission\\_grid\\_farmers.PDF](https://us.axa.com/docs/annuity/rc13_commission_grid_farmers.PDF).
- Bergstresser, Daniel, John Chalmers, and Peter Tufano. 2009. "Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry." *The Review of Financial Studies* 22(10): 4129-4156.
- Berkowitz, Jeremy , Renzo Comolli, and Patrick Conroy. 2015. "Review of the White House Report Titled `The Effects of Conflicted Investment Advice on Retirement Savings'." NERA Economic Consulting, 15 March 2015. [http://www.nera.com/content/dam/nera/publications/2015/PUB\\_WH\\_Report\\_Conflicted\\_Advice\\_Retirement\\_Savings\\_0315.pdf](http://www.nera.com/content/dam/nera/publications/2015/PUB_WH_Report_Conflicted_Advice_Retirement_Savings_0315.pdf)
- Biggs, Andrew G. and Glenn R. Springstead. 2008. "Alternate Measures of Replacement Rates for Social Security Benefits and Retirement Income." *Social Security Bulletin*, Vol. 68(2): 1-19.
- Bluethgen, Ralph, Andreas Gintschel, Andreas Hackethal and Armin Mueller. (2008). "Financial Advice and Individual Investors' Portfolios". Available at SSRN: <http://ssrn.com/abstract=968197>.
- Brady, Peter and Michael Bogdan. 2014. "Who Gets Retirement Plans and Why, 2013." ICI Research Perspective 20, No. 6 (October). Available at [www.ici.org/pdf/per20-06.pdf](http://www.ici.org/pdf/per20-06.pdf)
- Bureau of Labor Statistics. 2014. "National Compensation Survey: Employee Benefits in the United States, March 2014." Available at <http://www.bls.gov/ncs/ebs/benefits/2014/ebbl0055.pdf>.
- Christoffersen, Susan and Richard Evans. 2015. Letter to the Department of Labor, September 21, 2015. Available at <http://www.dol.gov/ebsa/pdf/1210-AB32-2-02766.pdf>.
- Christoffersen, Susan E.K., Richard Evans, and David K. Musto. 2013. "What Do Consumers' Fund Flows Maximize? Evidence from Their Brokers' Incentives." *Journal of Finance* 68(1): 201-235.
- Compass Lexecon. 2015. "Tax Consequences Resulting from Proposed Rules Relating to Financial Representative Fiduciary Status." July 20, 2015. Appendix 5 to the Comments of Primerica. Available at <http://www.dol.gov/ebsa/pdf/1210-AB32-2-00615.pdf>.
- Copeland, Craig. 2014. "Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2013" Employee Benefit Research Institute Issue Brief 405. Available at [http://www.ebri.org/pdf/briefspdf/EBRI\\_IB\\_405\\_Oct14.RetPart.pdf](http://www.ebri.org/pdf/briefspdf/EBRI_IB_405_Oct14.RetPart.pdf).

- Copeland, Craig. 2015. "Individual Retirement Account Balances, Contributions, and Rollovers, 2013; With Longitudinal Results 2010–2013: The EBRI IRA Database." *EBRI Issue Brief*, no. 414, Employee Benefit Research Institute. Available at [http://www.ebri.org/pdf/briefspdf/EBRI\\_IB\\_414.May15.IRAs.pdf](http://www.ebri.org/pdf/briefspdf/EBRI_IB_414.May15.IRAs.pdf).
- Council of Economic Advisers. 2015 ("White House report"). "The Effects of Conflicted Investment Advice on Retirement Savings." Available at [https://www.whitehouse.gov/sites/default/files/docs/cea\\_coi\\_report\\_final.pdf](https://www.whitehouse.gov/sites/default/files/docs/cea_coi_report_final.pdf).
- Del Guercio, Diane, and Jonathan Reuter. 2014. "Mutual Fund Performance and the Incentive to Generate Alpha." *Journal of Finance* 69: 1673-1704.
- DOL. 2011. "Investment Advice—Participants and Beneficiaries." U.S. Department of Labor, *Federal Register*, October 25, 2011, pages 66136-66167.
- DOL. 2015. "Fiduciary Investment Advice: Regulatory Impact Analysis." Available at <http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf>.
- Dushi, Irena, Howard M. Iams and Jules Lichtenstein. 2011. "Assessment of Retirement Plan Coverage," *Social Security Bulletin*, Vol. 71(2): 53-65. Available at <https://www.ssa.gov/policy/docs/ssb/v71n2/v71n2p53.pdf>.
- Europe Economics. 2014. "Retail Distribution Review Post Implementation Review." 16 December 2014. Available at <http://www.fca.org.uk/static/documents/research/rdr-post-implementation-review-europe-economics.pdf>.
- Financial Engines. 2015. "Missing out: How Much Employer 401(K) Matching Contributions Do Employees Leave on the Table?" Available at <https://corp.financialengines.com/docs/Financial-Engines-401k-Match-Report-050615.pdf>.
- FutureAdvisor. 2015. "What Is the Account Minimum for the FutureAdvisor Premium Service?", available at <https://futureadvisor.tenderapp.com/kb/going-premium/what-is-the-account-minimum-for-the-futureadvisor-premium-service>.
- GAO. 2014. "401(k) Plans Greater Protections Needed for Forced Transfers and Inactive Accounts." Available at <http://www.gao.gov/assets/670/667151.pdf>.
- Garber, Steven, Jeremy Burke, Angela Hung and Eric Talley. 2015. "Potential Economic Effects on Individual Retirement Account Markets and Investors of DOL's Proposed Rule Concerning the Definition of a 'Fiduciary'." RAND Report RR-1009-DOL, available at <http://www.dol.gov/ebsa/pdf/conflictsofinterestreport6.pdf>.
- Gerhardt, Ralf and Andreas Hackethal. 2009. "The Influence of Financial Advisors on Household portfolios: A study on Private Investors switching to Financial Advice." Goethe-University, Frankfurt am Main.
- Greenwald & Associates. 2014. "The Impact of the Upcoming Re-Proposed Department of Labor Fiduciary Regulation on Small Business Retirement Plan Coverage and Benefits." Available at [http://ushcc.com/wp-content/uploads/2014/05/survey\\_0029436\\_embargoed\\_002095743.pdf](http://ushcc.com/wp-content/uploads/2014/05/survey_0029436_embargoed_002095743.pdf)
- Hedges, Bob, Uday Singh and Monica Gabel. 2015. "Hype vs. Reality: The Coming Waves of "Robo" Adoption." A.T. Kearney.
- ICI. 2006. "401(k) Plans: A 25-Year Retrospective." ICI Research Perspective 12(2).
- ICI. 2015a. Letter from Brian Reid and David W. Blass of the Investment Company Institute to the U.S. Department of Labor, July 21, 2105. Available at <http://www.dol.gov/ebsa/pdf/1210-AB32-2-00749.pdf>.

- ICI. 2015b. Letter from Brian Reid and David W. Blass of the Investment Company Institute to the U.S. Department of Labor, September 24, 2015. Available at <http://www.dol.gov/ebsa/pdf/1210-AB32-2-03056.pdf>.
- ICI. 2015c. Letter from Brian Reid and David W. Blass of the Investment Company Institute to the U.S. Department of Labor, December 1, 2015.
- ICI. 2015d. "2015 Investment Company Fact Book." Investment Company Institute. Available at [http://icifactbook.org/pdf/2015\\_factbook.pdf](http://icifactbook.org/pdf/2015_factbook.pdf).
- ICI. 2015e. "The IRA Investor Profile: Traditional IRA Investors' Activity, 2007–2013." Available at [https://www.ici.org/pdf/rpt\\_15\\_ira\\_traditional.pdf](https://www.ici.org/pdf/rpt_15_ira_traditional.pdf).
- ICI. 2015f. "The IRA Investor Profile: Roth IRA Investors' Activity, 2007–2013." Available at [https://www.ici.org/pdf/rpt\\_15\\_ira\\_roth\\_investors.pdf](https://www.ici.org/pdf/rpt_15_ira_roth_investors.pdf).
- International Actuarial Association. 2013. "Stress Testing and Scenario Analysis." Available at [http://www.actuaries.org/CTTEES\\_SOLV/Documents/StressTestingPaper.pdf](http://www.actuaries.org/CTTEES_SOLV/Documents/StressTestingPaper.pdf).
- Investment Funds Institute of Canada. 2012. "The Value of Advice Report 2012." Available at <https://www.ific.ca/wp-content/uploads/2013/02/IFIC-Value-of-Advice-Report-2012.pdf/1650>.
- Jackson National Life Insurance Company. 2013. "Commission Schedule Variable Annuity Contracts." Available at <http://www.cri4.com/crcl/fesco/VAUpdates/Commission Updates/Jackson National VA Commission Update Sept 2013.pdf>.
- Kaplan, Eve. 2012. "9 Reasons You Need To Avoid Variable Annuities," July 2, 2012. Available at <http://www.forbes.com/sites/feeonlyplanner/2012/07/02/9-reasons-you-need-to-avoid-variable-annuities>.
- Kinniry, Francis M., Colleen M. Jaconetti, Michael A. DiJoseph, and Yan Zilbering. 2014. See Vanguard (2014a).
- Kramer, Marc M. 2012. "Financial Advice and Individual Investor Portfolio Performance." *Financial Management* Summer 2012, 395-428.
- Litan, Robert and Hal Singer. 2015a, "Good Intentions Gone Wrong: The Yet-To-Be-Recognized Costs of the Department of Labor's Proposed Fiduciary Rule," July 2015. Available at <http://www.dol.gov/ebsa/pdf/1210-AB32-2-00517.pdf>.
- Litan, Robert and Hal Singer. 2015b. Letter to the U.S. Department of Labor, September 21, 2015. Available at <http://www.dol.gov/ebsa/pdf/1210-AB32-2-02967.pdf>.
- Loewenstein, George, Daylian M. Cain, and Sunita Sah. 2011. "The Limits of Transparency: Pitfalls and Potential of Disclosing Conflicts of Interest." *American Economic Review* 101(3): 423-428.
- Maack, J., 2001. "Scenario Analysis: A Tool for Task Managers." Social Development Paper no. 36. Social Analysis: Selected Tools and Techniques. World Bank, Washington, D.C. Available at <http://siteresources.worldbank.org/EXTSOCIALDEV/Resources/3177394-1167940794463/ScenarioAnalysisMaack.pdf>
- Montmarquette, Claude and Nathalie Viennot-Briot. 2012. "Econometric Models on the Value of Advice of a Financial Advisor." CIRANO. Available at <http://www.cirano.qc.ca/pdf/publication/2012RP-17.pdf>.
- Montmarquette, Claude and Nathalie Viennot-Briot. 2015. "The Value of Financial

- Advice." *Annals of Economics and Finance* 16(1), 69-94.
- NERA. 2015a. "Comment on the Department of Labor Proposal and Regulatory Impact Analysis." NERA Economic Consulting, July 17, 2015. Appendix 1 to the Comments of the Securities Industry and Financial Markets Association, July 20, 2015. Available at <http://www.dol.gov/ebsa/pdf/1210-AB32-2-00506.pdf>.
- NERA. 2015b ("NERA Response"). "Answers to Questions Regarding NERA's 'Comment on the Department of Labor Proposal and Regulatory Impact Analysis.'" NERA Economic Consulting, September 21, 2015. Attached to letter from Kenneth E. Bensten, Jr. to Joseph Piacentini, September 24, 2015. Available at <http://www.dol.gov/ebsa/pdf/1210-AB32-2-03079.pdf>.
- Oliver Wyman, Inc. 2011. "Assessment of the impact of the Department of Labor's proposed 'fiduciary' definition rule on IRA consumers." Available at <http://www.dol.gov/ebsa/pdf/WymanStudy041211.pdf>.
- Oliver Wyman, Inc. 2015. "The Role of Financial Advisors in the U.S. Retirement Market." Available at <http://www.dol.gov/ebsa/pdf/1210-AB32-2-00515.pdf>.
- Panis, Constantijn and Michael J. Brien. 2016. "Financial Asset Holdings of Households in the United States in 2013."
- Panis, Constantijn. 2015. "Comments on a Review of a White House Report on Conflicted Investment Advice." Available at <http://www.dol.gov/ebsa/pdf/conflictsofinterestresearchpaper1.pdf>.
- Panis, Constantijn. 2014. "Review of Study by Quantria Strategies, LLC." Available at <http://www.dol.gov/ebsa/pdf/conflictsofinterestreport2.pdf>.
- Quantria. 2014. "Access to Call Centers and Broker Dealers and Their Effects on Retirement Savings." Quantria Strategies, LLC. Available at [http://quantria.com/DistributionStudy\\_Quantria\\_4-1-14\\_final\\_pm.pdf](http://quantria.com/DistributionStudy_Quantria_4-1-14_final_pm.pdf).
- Quantria. 2015. "Unintended Consequences: Potential of the DOL Regulations to Reduce Financial Advice and Erode Retirement Readiness." July 2015, Attachment to Comments of Davis & Harman, July 21, 2015. Available at <http://www.dol.gov/ebsa/pdf/1210-AB32-2-00746.pdf>.
- Reuter, Jonathan. 2015. "Evaluating the Performance of Broker-Sold Funds." Available at [https://www2.bc.edu/jonathan-reuter/research/brokers\\_revisited\\_201511.pdf](https://www2.bc.edu/jonathan-reuter/research/brokers_revisited_201511.pdf).
- Rieker, Matthias. 2015. "Fiduciary or Broker? Many Financial Advisers Wear Both Hats." *Wall Street Journal*, February 25, 2015.
- Sah, Sunita, George Loewenstein and Daylian M. Cain, 2013. "The Burden of Disclosure: Increased Compliance with Distrusted Advice," *Journal of Personality and Social Psychology* 104(2): 289-304.
- Schrass, Daniel. 2013. "Ownership of Mutual Funds through Investment Professionals, 2012." ICI Research Perspective 19, No. 2 (February). Available at [www.ici.org/pdf/per19-02.pdf](http://www.ici.org/pdf/per19-02.pdf).
- Scism, Leslie. 2012. "Insurance Fees, Revealed." *Wall Street Journal*, March 30, 2012.
- SEC. 2015. "Mutual Fund Fees and Expenses" webpage of the SEC, available at <http://www.sec.gov/answers/mffees.htm>.
- SigFig. 2016. Available at <https://www.sigfig.com/site/#/pricing>.
- Tergesen, Anne. 2015. "Automated 'Robo' Adviser Lowers Its Investment Minimum."

*Wall Street Journal*, November 20, 2015.

U.S. Census Bureau. 2015. "Business Dynamics Statistics." Available at [http://www.census.gov/ces/dataproducts/bds/data\\_firm.html](http://www.census.gov/ces/dataproducts/bds/data_firm.html).

UBS. 2015. "Understanding Our Fees, Charges and Other Compensation." Available at [https://www.static-ubs.com/us/en/wealth/about\\_us/fees\\_compensation/\\_jcr\\_content/par/linklist\\_ee5/link.1510904521.file/bGluay9wYXRoPS9jb250ZW50L2RhbS9zdGF0aWMvd21hbWVyaWNhcy91bmRlcnN0YW5kaW5nX291cl9mZWVzLnBkZg==/understanding\\_our\\_fees.pdf](https://www.static-ubs.com/us/en/wealth/about_us/fees_compensation/_jcr_content/par/linklist_ee5/link.1510904521.file/bGluay9wYXRoPS9jb250ZW50L2RhbS9zdGF0aWMvd21hbWVyaWNhcy91bmRlcnN0YW5kaW5nX291cl9mZWVzLnBkZg==/understanding_our_fees.pdf).

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

Vanguard. 2014a. "Putting a Value on Your Value: Quantifying Vanguard Advisor's Alpha," March 2014. Available at <http://www.vanguard.com/pdf/ISGQVAA.pdf>.

Vanguard. 2014b. "How America Saves 2014: A Report on Vanguard 2013 Defined Contribution Plan Data." Available at <https://institutional.vanguard.com/iam/pdf/HAS14.pdf>.

White House Report. 2015. See Council of Economic Advisers (2015).



## **DISCLAIMER**

The views, opinions, and/or findings contained in this report should not be construed as an official Government position, policy or decision, unless so designated by other documentation issued by the appropriate governmental authority.

We call your attention to the possibility that other professionals may perform procedures concerning the same information or data and reach different findings than Advanced Analytical Consulting Group, Inc. (AACG) for a variety of reasons, including the possibilities that additional or different information or data might be provided to them that was not provided to AACG, that they might perform different procedures than did AACG, or that professional judgments concerning complex, unusual, or poorly documented matters may differ.

This document contains general information only. AACG is not, by means of this document, rendering business, financial, investment, or other professional advice or services. This document is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action. Before making any decision or taking any action, a qualified professional adviser should be consulted. AACG, its affiliates, or related entities shall not be responsible for any loss sustained by any person who relies on this publication.

This document represents the final versions of the third and fourth Critical Reviews pursuant to Task Order DOL-OPS-15-T-00059 and the first, second, third, and fourth Critical Reviews pursuant to Task Order DOL-OPS-15-T-00186 under Contract DOL-OPS-14-D-0021.