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Comment to the SEC on the Standards of Conduct for Investment Advisers and Broker-Dealers

On behalf of a group of firm clients, we are writing with respect to the public statement issued on June 1, 2017 by Chairman Jay Clayton, welcoming public comments on the standards for conduct for investment advisers and broker-dealers. This comment focuses on the critical interaction between possible action by the Securities and Exchange Commission (the "SEC") and the Department of Labor's ("DOL") new definition of a fiduciary, new prohibited transaction exemptions, and modifications of existing exemptions (together referred to herein as the "Fiduciary Rule" or the "Rule").

As discussed further below, the Fiduciary Rule is already doing great harm to small investors, depriving them of access to investment advice in many cases and pricing them out of the advice market in other cases. These adverse effects are poised to become much worse when the new IRA private right of action becomes applicable, which is currently scheduled to occur on January 1, 2018.

This comment focuses on the opportunity being presented to the SEC by the review of the Fiduciary Rule mandated by the President, as well as the risk posed to the SEC of not being involved in that review.

Limited SEC choices if DOL does not materially reform the Fiduciary Rule. If DOL does not materially reform the Fiduciary Rule, the SEC has three basic choices:

- Conform its investment advice rule to the DOL Fiduciary Rule, thereby spreading the adverse effects of the Fiduciary Rule beyond the retirement area;
- Prescribe different rules, thereby exacerbating the current confusion and inconsistency for investors; or
- Inaction, in which case the SEC is preserving the current confusion and effectively deferring to DOL with respect to the critical rules governing investment advice regarding IRAs.

Under any of the choices, if DOL does not materially reform the Fiduciary Rule, the SEC's role would be reduced dramatically with respect to IRA owners. Regardless of which of the above choices is made by the SEC, the Fiduciary Rule would, on an ongoing basis, play the dominant role with respect to advice to IRA owners, thereby making it difficult for the SEC to fulfill its mission of protecting investors.

- If the SEC conforms to the DOL Fiduciary Rule, the Obama DOL process will have dictated the SEC result, depriving the SEC of the opportunity to use its expertise to protect investors.
- If the SEC prescribes more workable rules or does nothing, advisors will still be compelled to comply with the more restrictive Fiduciary Rule, rendering the SEC rules far less meaningful, except as a source of further confusion and cost.

The SEC can fulfill its mission by coordinating on a uniform rule with DOL, but this needs to be done before the application of the portion of the Fiduciary Rule scheduled to become applicable January 1, 2018. In order for the SEC to fulfill its mission to protect investors, the DOL must not finalize the portion of the Fiduciary Rule that is scheduled to become applicable as of January 1, 2018. That part of the Fiduciary Rule contains vague subjective rules and a new contract-based private right of action. Together, those elements will inevitably give rise to countless state law class actions, such as whenever the market goes down or due to plaintiffs' lawyers perceiving a business opportunity. The damage done by that portion of the Fiduciary Rule will exceed even the great damage done by the portion of the Rule that became applicable as of June 9th. Far more investors will lose access to advice or will be priced out of the advice market.

At some point, certain damage to the system could become irreparable if the January 1, 2018 portion of the Rule becomes applicable. Industry will have ceased to provide services to small accounts and will have converted many brokerage accounts to advisory accounts. As the SEC knows far better than anyone else, such conversions should occur based on customers' attributes and choice, but under the DOL Rule, such conversions can in some cases be dictated by the enormous liabilities imposed on brokerage accounts.

The right answer: a uniform workable best interest standard that protects investors. The right answer is for the DOL to hit the pause button on the January 1, 2018 portion of the Rule while it conducts a thorough review of the Rule in coordination with the SEC. The objective of that coordinated effort should be the development of a workable SEC best interest standard that (1) requires broker-dealers to act in the best interest of their clients, and (2) is coordinated with the DOL Rule in the following ways:

- The January 1, 2018 portion of the Fiduciary Rule is delayed so that it does not become applicable until the SEC rule becomes applicable.
- The SEC standard is developed based on the SEC's experience and expertise, not based on the Obama Fiduciary Rule.
- The DOL Fiduciary Rule is revised to apply the same best interest standard.

- With respect to any investment advice subject to the SEC rule, DOL grants a prohibited transaction exemption for such advice to the extent that it complies with the SEC standard.

This structure would reach the right result: a uniform workable best interest standard that protects investors.

First challenge in achieving this uniform workable best interest standard: expeditious SEC action. The SEC is far more knowledgeable than the industry on how best to develop a workable best interest standard expeditiously. Please know, however, that the industry stands ready to support you in that endeavor, ***provided that the January 1, 2018 portion of the Fiduciary Rule is delayed so that it does not become applicable until the SEC rule becomes applicable***. If the full DOL Fiduciary Rule becomes applicable, then the industry would be facing an SEC rule *in addition to* the harmful DOL Rule, which would just be adding layers of burdens, and not solving anything.

Second challenge in achieving this uniform workable best interest standard: delaying the January 1, 2018 portion of the Fiduciary Rule. There are ample grounds on which to delay the January 1, 2018 portion of the Fiduciary Rule under the Administrative Procedure Act (the "APA"). We will need the SEC and DOL working together to achieve this, however, which is why we include the following APA discussion in this SEC comment.

Legal standard for delaying January 1, 2018 portion of the Fiduciary Rule. Section 706 of the APA states in relevant part that where a court is reviewing the actions of an agency:

> The reviewing court shall hold unlawful and set aside agency action, findings, and conclusions found to be . . . arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.

In upholding the Fiduciary Rule, the United States District Court for the District of Columbia articulated this standard of review in this manner:

> The scope of judicial review under [the APA] standard is narrow. . . .The Court must satisfy itself that the agency has "examine[d] the relevant data and [has] articulate[d] a satisfactory explanation for its action including a rational connection between the facts found and the choice made."

NAFA v. Perez, et al., Case No. 1:16-cv-1035-RDM (D.D.C. Nov. 4, 2016) (Judge Randolph D. Moss), at 71.

According to the very courts that upheld the Fiduciary Rule, their decisions stand only for the proposition that there is a rational basis for the Fiduciary Rule. ***There has been no holding by any court that the Fiduciary Rule is the only correct interpretation of the statute, or that it is even the best interpretation of the statute.*** In this context, according to the very courts that upheld the Fiduciary Rule, all that is needed to delay the January 1, 2018 applicability date is a rational basis for doing so.

There is a mountain of new evidence that the Fiduciary Rule is causing great harm, providing far more than a rational basis for delaying the January 1, 2018 applicability date of the Fiduciary Rule while the Rule is studied further. After the publication of the Fiduciary Rule last year, a very significant amount of new data has been collected showing that DOL's 2016 economic analysis, which provided the basis for the Rule, was broadly incorrect and that the Rule is causing great harm. Attached to this document is an Appendix assembled by financial services trade associations, providing a range of powerful new data. Set forth below are examples of this new data:

- **DOL economic analysis (page 312):** "[T]he Department believes that quality, affordable advisory services will be amply available to small plans and investors under the final rule and exemptions."
    - **Actual results:** CoreData Research UK, which is the London unit of a global financial services research and strategy consultancy, issued a ***non-commissioned report*** based on an October 2016 survey of 552 U.S. financial advisors. This independent study found that over 70% of advisors will cease providing services to many small investors.
    - **Actual results:** In October of 2016, A.T. Kearney, a global management consultant, published a study of the effects of the Fiduciary Rule, in connection with a discussion of how Kearney can help financial institutions adjust to the Rule. Kearney recommended that consideration be given to ceasing providing services to retirement accounts under $200,000. Moreover, Kearny concluded that "[a]dvisers will mostly stop service to low-balance IRAs."

- **DOL economic analysis (page 313):** "[R]evisions to the 2015 Proposal reflected in the Best Interest Contract Exemption will reduce compliance costs and thereby help make advice affordable to small investors."
    - **Actual results:** CoreData has found that almost 40% of advisors believe that ***most*** investors will be priced out of the retirement advice market because of the Fiduciary Rule.

The above new data and the data in the attached Appendix call into serious question DOL's 2016 economic analysis. It is inconceivable that adopting a delay of the January 1, 2018 date to consider this new data could be considered arbitrary and capricious. In fact, frankly, it is hard to imagine a rationale for not taking the time to examine this new data.

Additional data on the harms of the Fiduciary Rule is being assembled in order to respond to the DOL Request for Information. That data will be forwarded to you as soon as it is available.

Without a whole new economic analysis, how can the Fiduciary Rule be further delayed? It has been argued by some that the January 1, 2018 date cannot be further delayed unless DOL's 2016 economic analysis has been fully refuted and there is a whole new economic analysis. That argument is flatly inconsistent with the APA in numerous ways.

First, just to be clear, as discussed above, the APA does not require an agency to use the best possible economic analysis. That is significant because nothing in any of the cases upholding the Fiduciary Rule found that DOL's 2016 economic analysis was "correct" or was the best analysis. On the contrary, all that the courts found was that there was a rational basis for the Rule, which is all that is required.

In this context, under APA cases, a rescission of the Fiduciary Rule would require a full economic analysis providing a rational basis for the rescission. But a further delay of the January 1, 2018 date is not a rescission or even close to a rescission. Accordingly, there is no need for a complete new economic analysis. All that is needed is an economic basis to analyze new information during the delay period. There is far more than enough of an economic basis to do that, as discussed above. In fact, a delay of the January 1, 2018 date would, in fact, lead to exactly the result that the APA was enacted to create: a better regulation based on more public input and on more facts.

We have learned a great deal since the finalization of the Fiduciary Rule in April 2016. We have a significant amount of new data regarding the adverse effects of the Fiduciary Rule. It is inconceivable that a delay of the January 1, 2018 date to facilitate a review of the new information -- including new data from independent sources -- could be invalidated by a court as arbitrary and capricious.

Opportunity to protect investors. We commend Chairman Clayton for issuing the statement welcoming public comment. As discussed above, if SEC becomes involved in the review of the DOL Fiduciary Rule, there is a great opportunity for the SEC to create a uniform best interest standard that protects investors, rather than harms them as the Fiduciary Rule does.

For questions regarding this comment, please contact Kent Mason at [redacted]

NEW DATA SHOWS DOL FIDUCIARY RULE HARMING SMALL RETIREMENT SAVERS $

Executive Summary

As ordered by the President, the Department of Labor requested new information about the economic effects of the Fiduciary Rule. This new data, based on actual experience rather than academic guesswork, shows that the Department's original predictions were wrong. The facts show that the Department significantly underestimated the negative effects of the rule, particularly in reducing access to advice for small retirement savers and small businesses. Specifically:

- A survey of advisors finds 71% will stop providing advice to at least some of their current small accounts due to the risk and increased costs of the rule.
- Other surveys found that 35% of advisors will stop serving accounts under $25,000, and 25% will raise their client minimum account thresholds.
- A major mutual fund provider reported that the number of orphaned accounts on its books (accounts no longer serviced by an advisor, leaving investors on their own) tripled in the first quarter of 2017 due to the fiduciary rule. These small accounts averaged $21,000. It further estimated that roughly 15% of its accounts would be orphaned following full implementation of the rule.
- A survey of insurance service providers shows 70% already have or are considering exiting the market for small balance IRAs and small plans, and half are preparing to raise minimum account requirements for IRAs.
- Lack of access to advice hurts retirement savers—a study shows that investors starting with $25,000 who receive advice save nearly three times more than their non-advised peers. This is due not only to investment recommendations, but to personal assistance in developing better saving rates and other financial behaviors.
- Many comments explained that a wide array of financial service providers are responding to the Rule's new litigation risks by limiting the investment types and products they will recommend.

The information also highlighted critical flaws in the Department's original analysis, including its reliance on old data, inadequate consideration of alternatives, not taking into account the benefits advisors provide while focusing on aspect of costs, and underestimating the impact on small businesses.

As this data shows, the Trump Administration should further delay the applicability date of the rule while it completes its full review in order to avoid harming the very people the rule is intended to help.

New Information: Loss of Consumer Access to Retirement Advice

- According to a 2016 study, Americans who work with a financial professional save more than Americans who do not, including saving twice as much over a seven- to 14-year period.[1] (IRI, Davis & Harman, FSR and Chamber)
- A 2016 study by CoreData found that 71 percent of financial professionals will disengage from at least some retirement savers because of the Fiduciary Rule, and 64 percent think the Fiduciary Rule will have a large negative impact on their mass-market clients (i.e., investors with less than $300,000 in net investable assets). On average, these financial professionals estimate they will no longer work with 25 percent of their mass-market clients, creating an advice gap for low-balance investors.[2] (IRI, Davis & Harman, ABA, Market Synergy, SIFMA, ACLI)
- A 2016 study by A.T. Kearney found that by 2020, broker-dealer firms (including wirehouses, independents, and dually-registered broker-dealer/registered investment advisers) will collectively stop serving the majority of the $400 billion currently held in low-balance retirement accounts. [3] (IRI, Davis & Harman, FSI)
- In a 2017 survey of IRI member firms, 70 percent of respondents either already have or are considering exiting smaller markets such as lower balance IRAs and small employer based plans, and nearly half already have or are considering raising IRA account minimums. [4] (IRI)
- A 2017 survey by the National Association of Insurance and Financial Advisors ("NAIFA") found that nearly 90 percent of financial professionals believe consumers will pay more for professional advice services, 75 percent have seen or expect to see increases in minimum account balances for the clients they serve, and 91 percent have already experienced or expect to experience restrictions of product offerings to their clients. [5] (IRI, NAIFA)
- One report notes that 35 percent of advisers surveyed "will move away from low-balance accounts" (*i.e.*, less than $25,000 in assets).[6] And "nearly one in four advisers said that they will likely increase their current client minimums as a result of the fiduciary rule, focusing their attention on higher-net worth clients and more profitable relationships."[7] (FSR)
- One large mutual fund provider reports that its number of orphaned accounts nearly doubled in the first three months of 2017, and that the average account balance in these orphan accounts is just $21,000. Further, it projects that ultimately 16% of the accounts it services will be orphaned this year because of the Fiduciary Rule. Extrapolating this prediction suggests that at least 1.6 million small retirement savers have already lost access to investment assistance since January 2017, and an additional 1.6 million are likely to lose access after the Rule becomes applicable. (Chamber, ICI)

- The National Conference of Insurance Legislators ("NCOIL") adopted a resolution stating that "the Rule will prevent consumer access to crucial retirement education and services, ultimately harming the very people it seeks to aid." (Market Synergy)
- According to a February 2017 survey of more than 1,000 investors conducted by J.D. Power, more than half (59 percent) who pay commissions now say they either "probably will not" (40 percent) or "definitely will not" (19 percent) be willing to stay with their current firm if it meant being forced to move to fee-based retirement accounts. (Market Synergy)
- A 2017 report indicates that the Rule will result in additional charges to retirement investors of approximately $800 per account or over $46 billion in aggregate.[8] (FSR, FSI, NAIFA)
- Many advisors plan to exit the business entirely. In a blind online poll of 459 advisors conducted by Fidelity Clearing & Custody Solutions from August 18-26, 2016, 10% of advisors reported they are planning to leave or retire from the field earlier than expected because of the rule, and another 18% said they are "reconsidering their careers as advisors.[9]
- "For example, effective April 10, 2017, specific distribution partners of Pacific Life will scale back the retirement products they offer, limiting competition and choice. Advisors plan to be more selective of the new investors they choose to service which will limit access to retirement information and personalized advice for many. In addition, distributors continue to identify and eliminate clients with small to modest account balances in anticipation of the added compliance costs and heightened litigation risks generated by compliance with the new rule. As a result a significant number of existing investors could lose access to an advisor to talk to, answer questions, and who can help encourage them to save more and remain invested over time."[10]
- "According the 2016 Global Survey of Financial Advisors published by Natixis Global Asset Management, more than three-quarters of advisors surveyed believe increased regulations could lead to higher costs for their clients. The Rule is specifically mentioned as being one of the primary drivers of increased regulatory costs. More alarming to small businesses, 38 percent of respondents said they were likely to "disengage from smaller clients." Because retirement plans sponsored by small businesses often pale in comparison to larger corporate retirement plans in terms of assets invested, small businesses face a greater likelihood of being dropped by their financial advisors."[11]
- "It is estimated the rule could disqualify up to 7 million IRA holders from investment advice and reduce the number of IRAs opened annually by between 300,000 and 400,000."[12]
- "According to Cerulli, two-thirds (66%) of advisors believe that small investors will have less access to professional financial advice as a result of the rule. And, according to a recent report by CoreData Research, 71% of surveyed U.S. advisors plan to disengage from "mass market" investors because of the DOL rule and these advisors estimate they will no longer

service 25% of their current clients – creating a potential "advice gap" for low balance investors."[13]

- Due to the requirements of BICE "Landenburg will be forced to preclude some lower cost investment options that may be appropriate for some clients and reduce available product offerings to only those that pay the same level compensation (even if that compensation is higher) to the Financial Institution. This will likely cause a broad reduction across multiple product categories and, in some categories, may reduce available products from over 100 to less than 10."[14]

New Information: Loss of Consumer Access to Retirement Products

- Some distribution firms and financial professionals have already significantly scaled back their use of commission-based products such as variable annuities because of concerns about the potential implications of the Fiduciary Rule on recommendations of such products. In fact, despite the existence of a rising stock market, which has always led to increased sales of variable annuities, sales declined by 21.6 percent from 2015 to 2016. [15] (IRI)
- Adverse effects on annuities have already occurred. "The variable annuity industry took a beating in 2016, with several of the top sellers inking losses upwards of 25% on the year and some exceeding 40%. The Department of Labor's fiduciary rule, issued in its final form last spring, played a big role in the industry's bruising, observers said."[16] (Davis & Harman, IRI)
- In 2015, variable annuities represented 56% of IRA annuity sales and 46% of 2016 IRA annuity sales. LIMRA projects that variable annuity purchases will decrease another 20-25% in 2017 if the Rule goes into effect.[17] (SIFMA)
- For IRA purchases, sales declined 22% in 2016 compared to the prior year.[18] The ambiguous regulatory structure of the Rule is expected to result in additional decreases in purchases of variable annuities, which represents a significant amount of IRA annuity purchases. (SIFMA)
- More than 80 percent of respondents to the 2017 IRI survey have already introduced, plan to introduce, or are considering introducing fee-based variable annuities. However, those products are unlikely to be widely available in the near-term and may not be appropriate for all retirement savers, including some for whom a traditional commission-based variable annuity would be more economical, less costly, and likely in their best interest. [19] (IRI)
- Several large intermediaries have already announced a variety of changes to service offerings, including firms no longer offering mutual funds in IRA brokerage accounts; others offering no IRA brokerage accounts at all; firms reducing web-based educational tools; and firms raising account minimums for advisory fees.[20] (ICI)

- Recent media reports have highlighted the decisions being made by some firms to change their service models and product availability, including (a) moving clients to fee-based accounts, (b) eliminating commission-based IRAs; (c) raising investment minimums for commission-based IRAs; (d) eliminating variable annuity products; and (e) excluding certain products from commission-based IRAs (*e.g.*, annuities, mutual funds, and exchange-traded funds).[21] (FSR)
- Many firms have already determined the BIC Exemption is unworkable for certain products, and the substantial threat of unwarranted litigation cannot be justified for certain accounts.[22] (ICI)
- Many companies will be inclined to reduce the universe of available investments in order to effectively mitigate potential conflicts of interest arising from different compensation amounts and cost structures, which the company does not control. Likewise, investment choice will be limited in order to ensure that financial institutions can comply with the numerous initial and ongoing disclosure requirements applicable to BICE. The technology and operational capabilities necessary to meet these disclosure obligations inevitably will cause us and others to offer fewer products in order to control the costs of these efforts.[23]
- "Firms have restricted product offerings to certain clients, thereby limiting consumer choice, and have abandoned traditional, lower-cost compensation arrangements for advisors (e.g., commissions, rather than high upfront management fees that small and first-time savers cannot afford) in order to avoid the cost of complying with the BIC Exemption and mitigate the threat of costly class action lawsuits." [24]
- "AAF found that three major companies have already left part of the brokerage business, and an additional six are drawing down their business or switching to a fee-based arrangement, depriving more consumers of investment advice."[25]
- "Over the 12-month period ending on September 30, 2016, industrywide sales of variable annuities with guarantees declined 24%."[26]
- "The National Economic Research Association estimates more than 57 percent of current retirement savings account holders will be forced out of their current plan by this rule. Economists from the Brookings Institution estimated the consumer loss could be $80 billion – twice as much as was projected by the Department of Labor – and a report from economic consulting firm Oliver Wyman concluded the rule could raise the price of financial advice by nearly 200 percent."[27]
- "According to the Insured Retirement Institute, 2016 sales of all annuities declined 7.6% from 2015, and 2016 sales of variable annuities, which under the Rule will fall under the complicated BICE regulations, fell 21.65% from 2015. Fourth quarter 2016 fixed indexed annuity sales declined 7% from third quarter 2016 sales. For 2017, the LIMRA Secure

Retirement Institute projects that total sales of US individual annuity sales will drop 10% to 15%, while sales of variable and indexed annuities will drop as much as 20% to 25%."[28]

- "Most notably, 91% of respondents [to a recent survey of NAIFA members] have already experienced or expect to experience restrictions on product offerings to their clients, nearly 90% believe consumers will pay more for professional advice services, and 75% have seen or expect to see increases in minimum account balances for the clients they serve."[29]
- "In fact, nearly half of NAIFA's members (46%) already have experienced a restriction of product offerings to their clients, and another 45% anticipate that such restrictions are forthcoming. More specifically, 68% of our members have been told that they cannot recommend certain mutual fund classes to clients, and over 70% say they cannot recommend certain annuities."[30]
- Due to BICE's requirements "KMS will be forced to preclude some lower cost investment options that may be appropriate for some clients and reduce available product offerings to only those that pay the same level compensation (even if that compensation is higher) to the Financial Institution. This will likely cause a broad reduction across multiple product categories and, in some categories, may reduce available products from over 100 to less than 10."[31]
- The Oxford Economics report warned that the DOL has "dramatically underestimated" the cost to comply with the new rule and that smaller firms would find it difficult to stay in business. The Oxford Economics study estimates the Fiduciary Rule will result in startup costs ranging from $1.1 million to $16.3 million per firm, depending on firm size. The study also found that because of the cost burdens, firms will shift their business model towards fee-based advising and create a minimum balance for client accounts. These account minimums will effectively force smaller investors into self-advised or robo-advice accounts. As compliance costs rise, fees for investors and account minimums rise, causing middle and lower class investors to be priced out of professional investment advice. The impact of being priced out of professional investment advice will have a permanent, long-term impact on investor's retirement savings."[32]

New Information: Value of Advice

- Reuter updates previous analyses based on data from 1994-2004 with newer data from 2004 – 2012. He finds a statistically significant decline in the apparent underperformance in earnings of commission broker sold, actively-managed mutual funds compared to actively-managed direct-sold funds. Instead of the 110 basis point disparity reported by Del Guericio and Reuter in their 2014 paper on which the Department relied for its regulatory impact analysis, Reuter reports that over the 2004-2014 period the disparity declined to 64 basis points. This decline suggests that the putative benefits estimated by the Department for the

Fiduciary Rule and the predicted costs of delaying its implementation are grossly (overvalued.[33] (Chamber, ABA, SIFMA) (

- Studies show that unadvised households tend to hold fewer equities than advised households. The likelihood of owning any stocks or stock-based mutual funds increases by 67% with the use of an advisor and the proportion dedicated to stock positions increases by 39%. Academic work clearly shows that asset allocation, not mutual fund selection, explains, on average, 100% of performance. If the Rule results in a reduction of equity allocations by only 15%, the ICI estimated that would result in a performance decline of 50-100 bps per year, on average, or $95 billion and $189 billion over the next 10 years and between $202 billion and $404 billion over the next 20 years. (ICI, SIFMA)
- New economic studies estimate that investors could lose $109 billion over 10 years because of the Rule's implementation. This would amount to $780 million per month in losses to investors. A 60-day delay would thus save investors $402 million in lost returns over 60 days. A 180-day delay would save more than $1.2 billion. Even a 60-day delay would amount to $414 million in lost returns saved for investors over the first year if the Rule ultimately goes forward as now structured and $542 million over a 10-year period (at a three percent discount rate). These lost returns far exceed the Department's estimated $104 million losses in the form of foregone gains— gains that, as shown above, are widely overstated. (SIFMA, ICI)
- Kinniry, et al., found that having a financial professional can make up to a 300 basis point difference in annual compound returns. They found that the greatest contributing factor of assistance, amounting to 150 basis points in annual compound rate of return, was the "behavioural coaching" element of the interactions between a customer and a financial professional.[34] (Chamber, FSR)
- A paper casts doubt on the social benefits of the Department's promotion of passive index fund investing. The paper shows that despite the apparent advantages to some individual investors, widespread and growing adoption of the strategy could distort capital markets in ways that could slow overall economic growth. The author shows how inclusion of a stock in an index fund may artificially raise its internal cost of capital calculations and discourage otherwise profitable investment decisions. He also illustrates how an index fund investor may be exposed to unforeseen risk of loss.[35] (Chamber)
- A report finds that many retirement savers are adverse to assistance from call centers or robots. The personal connection with a financial professional is important for educating and motivating savings behavior.[36] (Chamber)
- "Studies indicate that households that have worked with a financial advisor over a 15-year period "have about 290% more financial assets than non-advised households," even though half of these households had less than $25,000 in savings when they initially began to work

with an advisor. "The discipline imposed by a financial advisor on households' financial behavior and increased savings of advised households are key to improving asset values of households relative to comparable households *without* an advisor." Indeed, some studies find that "behavioral coaching can add 1% to 2% in net return."[37]

New Information: Increased Litigation

- The increased litigation stemming from the inappropriate use of the private right of action in enforcing the BIC Exemption will result in $70 and $150 million in costs to the industry each year.[38] (IRI and Chamber)
- Data shows that class action lawsuits like the type that would flow from the Rule provide almost no benefit to the class members of the action, but rather just help their lawyers.[39] (Chamber, ICI, FSR, Market Synergy)
- Companies interviewed by the Chamber suggest insurance costs could exceed two to three times the cost estimated by the Department. Some respondents to Chamber interviews cited numbers as high as $10,000 per professional per year for Errors and Omissions coverage. (Chamber, NAIFA)
- Expanded incentive for class action litigation results in defendant's settling with an extremely litigious plaintiff's bar instead of spending years tied up in discovery. A survey of lawsuits filed against fiduciaries in recent years demonstrates how plaintiff's use these settlements to fund future lawsuits.[40] (ARA, ICI)
- In 2016, nearly 4,000 FINRA arbitration cases were filed by consumers alleging broker-dealer wrongdoing (only 158 of those cases were decided in favor of the consumer)- meaning that broker-dealers spent a lot of time and money defending these cases.[41]
- A SIFMA survey indicated "… more than 60% of the responding firms stated that they anticipate that some or all of the costs resulting from the potential increase in litigation and liability insurance may be passed on to clients."
- "An equity analyst from Morningstar stated that annual litigation costs will be $70MM-$150MM per year."[42]
- "A February 2017 study prepared by the Lockton Companies indicated that the costs to get through a motion to dismiss range from $500,000-$750,000. Beyond that, discovery costs alone can reach between $2.5 million and $5 million."[43]
- "Participants are not the primary beneficiaries of these awards, as a Fiduciary Benchmarks survey conducted in 2016 concluded that out of $698 million awarded, attorneys received $204 million and the average participant award was $116."[44]

New Information: Compliance Costs

- The Securities Industry and Financial Markets Association estimates that annual compliance costs will range from $240 million to $570 million over the next ten years.[45] (SIFMA)
- Small broker-dealers face the greatest financial risk under the Rule, forcing potential consolidation of broker-dealers.[46] (SIFMA, FSI, FSR)
- One recent study by the American Action Forum found reported compliance costs of at least $106 million in 2016, representing up-front costs from just four companies. (Market Synergy)
- The DOL's RIA grossly underestimated the cost of the rule.[47] (FSI)
- "The costs that will be incurred to comply will most likely force smaller firms to consolidate or close their doors. In other words, lost jobs. A Morningstar quote for their technology solution which would assist with compliance procedures was $1,014,540 annually. We don't have $1,000,000 of net income annually. How would we pay for this? Other solutions quoted in the several hundred thousand dollar range, again annually. We have already spent over $300,000 in legal costs and staff hours trying to develop our compliance procedures. We won't survive."[48]
- "The proposed rule has already substantially increased our compliance costs. We estimate compliance costs have increased 450% as a result of this rule."[49]
- "Our research has found that almost all retail investors will see their costs increased by 73 to 196 percent due to a mass shift toward fee-based accounts. Further, firms providing investment advice will see an average of $21.5 million in initial compliance costs and $5.1 million in annual maintenance costs. Even worse, up to 7 million Individual Retirement Accounts (IRAs) would fail to qualify for an advisory account due to the balance too low to be sustainable for the advisor. In the shorter term, we found that the fiduciary rule, as written, will result in over $1500 of duplicative fees charged per household retirement account."[50]
- "AAF also found reported compliance costs of more than $106 million in 2016, representing up-front compliance costs of just four companies."[51]
- "Goldman Sachs estimated that initial compliance with the Fiduciary Rule would cost the financial services industry $14 billion and on-going annual compliance would cost it $7 billion."[52]
- "Industry estimates show that the rule will cost $5 billion to implement and $1 billion annually to maintain."[53]
- "Implementing the DOL's new fiduciary rule for retirement accounts will cost the brokerage industry $11 billion in revenue over the next four years, according to a recent study from A.T. Kearney, a consultant."[54]

- "The Oxford Report estimated that the Rule would result in startup costs ranging from $1.1 million to $16.3 million per [Individual broker dealer] firm, depending on firm size."[55]
- "To date, Advisors Excel has spent in excess of $1 million in preparation for the Rule. Across the financial industry, compliance estimates range from Ameriprise spending in excess of $11 million in the first part of 2016, to an estimate by the Securities Industry and Financial Markets Association ("SIFMA") indicating start-up costs for large and medium broker-dealers would total $4.7 billion with on-going costs of $1.1 billion."[56]

Procedural Flaws

- An inquiry initiated by Senator Ron Johnson (R-Wisconsin) in 2015 found the Department "was predetermined to regulate the industry and sought evidence to justify its preferred action." In other words, the Department first concluded that it wanted to change the rules governing investment advice fiduciaries, and then sought to justify that conclusion. (IRI, Davis & Harman)
- The Department failed to consider how the Rule would likely create an "advice gap" for low- to middle-income families. The Department dismissed concerns of loss of access, and instead found "little evidence" that "financial advisers improve retirement savings." However, this conclusion is contradicted by the Department's own assessment in a prior rulemaking that investment mistakes cost investors approximately $114 billion per year, that access to financial assistance reduced the cost of those mistakes by $15 billion per year, and that increased access to financial assistance would enable them to save billions more. (IRI)
- The Department chose to ignore evidence regarding the impact of similar rules established in other jurisdictions. Most notably, following the United Kingdom's 2013 move to a fee-based compensation model, the U.K. regulator determined that retirement savers – particularly those with lower incomes – were adversely affected and acknowledged that its "high standard of advice is primarily accessible and affordable only for the more affluent in society." Rather than taking advantage of the opportunity to learn from mistakes made by other countries, the Department simply denied the existence of an "advice gap" in the U.K. and dismissed the possibility that a similar "advice gap" would develop in the U.S. under the Fiduciary Rule. (IRI, Chamber, ICI and Davis & Harman)
- Under Executive Order 12866[1] and related guidance issued by OMB,[2] consideration of viable alternatives is a fundamental element of federal agency rulemaking. However, the lack of consideration given to all relevant costs of the Fiduciary Rule prevented the

[1] Exec. Order No. 12,866, 3 C.F.R. 638 (1993). (
[2] Office of Mgmt. & Budget, Circular No. A-4, Regulatory Analysis (Sept. 17, 2003). (

Department from properly evaluating less burdensome alternatives that would have greatly reduced the costs of the Fiduciary Rule, harmonized the Department's regulatory regime with that of the SEC and, because they would have applied only to relationships in which the client has no reasonable expectation of fiduciary status, would not have caused any meaningful consumer harm. However, as a result of the Department's flawed process, it arbitrarily rejected these and other alternatives. (IRI)

- According to the Johnson Report discussed above, the Department failed to adequately consider comments from expert regulators and professionals staffers from the SEC, OIRA and the Treasury Department expressing concerns and offering recommendations regarding the Rule. (IRI, Davis & Harman)
- "Further, the Department of Labor underestimated the impact of the Rule on small and independent businesses by insufficiently fulfilling its obligations under the Regulatory Flexibility Act (RFA). The RFA requires agencies to consider the impact of their regulatory proposals on small entities, to analyze effective alternatives that minimize small entity impacts, and to make their analyses available for public comment. It is the role of the U.S. Small business Administration's Office of Advocacy to advance the views, concerns, and interests of small business before Congress, the White House, federal agencies, federal courts, and state policy makers. The Office of Advocacy is the government's expert on the RFA. In this role, the Office of Advocacy comments to federal agencies regarding the impact of proposed regulations on small business and provides feedback on agency analyses of the regulatory impact. Under the RFA, an agency is required to examine whether its proposed rule will have a significant economic impact on a substantial number of small entities. If the agency determines that its proposed rule will have such an impact, it is required to prepare an initial regulatory flexibility analysis (IRFA). The IRFA must meet several requirements spelled out by section 603 of the RFA, including what small businesses are expected to be directly impacted, the major cost factors, and consideration of all significant regulatory alternatives. The RFA requires agencies to publish the IRFA, or a summary, in the Federal Register at the same time it publishes the proposed rulemaking. In its public comment letter to the Department of labor of July 17, 2015, the Office of Advocacy wrote that it had found the IRFA for the Rule deficient."[57]

<u>Analytical Flaws</u>

- According to a February 2017 analysis by the American Action Forum, it is unclear how CEA found that $1.7 trillion of IRA assets involved conflicts of interest. Total affected IRA assets are significantly less. Retirement account assets were $7.3 trillion in 2013, 86.2 percent of which, by the CEA's own definition, were not "conflicted." That leaves less than $1 trillion in so-called "conflicted" assets. And even that amount is too large because it represents total "conflicted" assets across all retirement accounts, while the CEA's analysis was limited to

IRA assets only. Total "conflicted" IRA assets are some amount less than $1 trillion. Also, as the CEA stated, the $1.7 trillion figure is some combination of front-load funds and variable annuity in IRAs. By including the annuity market, the CEA increased total affected assets by approximately $600 billion, or about 50 percent. (Market Synergy, ACLI, SIFMA)

- The Final RIA is deficient because the Regulation is built on two false premises: all commission-based sales are conflicted, and all fee-only advice is always unconflicted and serves retirement savers' best interest. Neither premise is correct, and neither is supported by the final RIA. (ACLI)
- The Department's Regulatory Impact Analysis only briefly addressed the impact the Rule would have on jobs, noting the Rule could have "some social costs." [58] (IRI, Davis & Harman)
- In projecting the costs of the Rule, the Department did not give due consideration to the costs of the Rule specifically applied to annuity manufacturers and distributors, despite several studies made available to the Department demonstrating the costs.[59] (IRI)
- The Regulatory Impact Analysis overstated the benefits of the Fiduciary Rule, underestimated the Fiduciary Rule's direct and indirect costs to the financial services industry and retirement savers, and, as described above, failed to give meaningful consideration to the costs to retirement savers from lost access to retirement assistance (including assistance with guaranteed lifetime income products such as annuities) and the transaction-based fee model as well as the costs of class action lawsuits arising from the BIC Exemption. The record shows those costs total tens of billions of dollars. (IRI, ICI)
- The Department relied on flawed and problematic factors and data in their Regulatory Impact Analysis projections. Specifically, the Department admitted to basing savers' projected financial gains on research regarding "only one" issue: the purported "conflict that arises from variation in the share of front-end-loads that advisers receive when selling different mutual funds that charge such loads to IRA investors." This research provides no basis for regulating products—such as annuities—that may not invest in mutual funds at all, and was not even a proper assessment of mutual fund performance. (IRI, ICI, FSR)
- Additionally, in estimating that the average mutual fund sold by brokers underperformed its benchmark, the Department improperly used performance data on certain unrepresentative funds to draw conclusions about the entire mutual fund market. The Department compounded this error by relying on data for the period 1993 through 2009 (a cherry-picked sample encompassing the entire global financial crisis and nearly none of the recovery) and basing its underperformance estimate not on actual holding periods, or even over a full market cycle, but rather on the single year in which funds were purchased. A series of comment letters from the Investment Company refuted this data, finding the Rule could cost investors $109 billion in additional fees.[60] (IRI, ICI, ACLI, SIFMA, NAIFA)

- Vanderbilt Professor and former SEC Chief Economist Dr. Craig Lewis noted the research relied on by the Department did not analyze the performance of mutual funds held in annuities, relied on old data not reflecting the current marketplace, and the author of one of the key studies later revised his work to show the "cost" of conflicts was about 1/6th of the amount originally estimated.[61] (Chamber, ABA, SIFMA)
- The Department was far too optimistic in relying on "robo advisers" to alleviate the potential loss of access to retirement advice for small savers. The Chamber of Commerce is currently unaware of any "robo advisor" that recommends annuity products to generate retirement income, despite the clear need for those products. (Chamber, ICI)
- The Department seemingly concludes that "robo advisors" and low-expense passive investment options are the best course of action for retirement investors, while ignoring the reality that there is no "one size fits all" investment strategy and even if some investors would benefit from this development, others would be harmed. The Department failed to address this potential impact in their Regulatory Impact Analysis. (Chamber)
- DOL failed to acknowledge that annuities are governed by a distinct, customized, and comprehensive regulatory framework that was enhanced in 2010 to account for annuities' unique features. The dated mutual fund studies relied upon by the Department, which focus primarily on investment performance in the historical period 1991 to 2005, do not measure the efficacy of targeted and more rigorous annuity-specific rules. (ACLI)
- "DOL's cost analysis is flawed on two accounts. First, DOL states that the fiduciary rule will save retirement savers $17 billion a year. It came to this conclusion by taking a uniform 1 percent off of the total amount of assets in IRAs in the United States. From a statistical standpoint, DOL failed to take into account the asset-weighted performance of funds. Craig Lewis of Vanderbilt's Owen School of Business provides an example of how this skews an analysis: "[A] non-asset weighted study examining nine funds each with $1 million invested yielding a 1 percent return and one fund with $10 million invested yielding a 10 percent return would show an average return of 1.8 percent. But an asset-weighted study looking at the same 10 funds would show an average return of 5.7 percent. By ignoring which funds investors actually invest in, the report fails to achieve its stated objective of measuring the market-wide impact of conflicted advice in retirement accounts." Second, DOL vastly underestimated the costs of compliance with the fiduciary rule. DOL estimated total startup compliance costs at $5 billion and ongoing costs of $1.5 billion. Even if true, these would make the fiduciary rule one of the most expensive regulations in history, but the costs are much higher than DOL's original estimates. AAF found that the fiduciary rule would cost $31.5 billion in total costs and $2 billion in annual burdens, making it the most expensive rule of 2016 and the second most expensive non-EPA rule since 2005."[62]

- "Among other things, the updated analysis should account for the following: (1) the Department should acknowledge that the data comprising most of the studies relied on by CEA are from the late 1990s and early 2000s, when there was scant overlap in the marketing and sale of broker-sold funds versus no-load funds. The competitive landscape now is markedly different, with 90% of front-load mutual funds also having no-load shares. (2) The author of one of the academic studies cited by CEA, Jonathan Reuter, issued an updated analysis that looked at more recent mutual fund performance (from 2003 to 2012) and concluded that broker-sold funds underperform no-load funds by an average of 18 basis points, significantly narrower than the 100-basis point difference cited by CEA. This means that CEA greatly overestimates with its projected $17 billion figure. (3) A survey of financial advisors by CoreData Research that was conducted after the Fiduciary Rule was finalized (October 2016) found that 71% plan to disengage from some mass-market investors due to the Fiduciary Rule. On average, these advisors further estimate that they will no longer service 25% of their mass-market clients, creating a significant likely advice gap for low-balance investors."[63]
- "The Department commented in its original release of the proposed Rule that the "research has shown that disclaimers are ineffective in alerting retail investors to the potential costs imposed by conflicts of interest," yet the Department has constructed a Rule that does just that. The Rule as written adds dozens of pages of disclaimers and disclosures for consumers to review in addition to the ones imposed by state insurance regulation."[64]
- "First, the Department's premise that investors will gain from the Rule is incorrect. Instead, investors will incur substantial quantitative and qualitative losses. The Rule has the potential to increase consumer costs by $46.6 billion, or $813 annually per account, in addition to the $1,500 in duplicative fees for retirement savers that have already paid a fee on their commission-based accounts. The RIA's assessment of the "Small Saver Market" is woefully inadequate. For example, the RIA spends a mere 14 pages of 376 assessing the very market segment the Rule purports to protect."[65]
- "Separately, the Investment Company Institute has pointed out that new economic studies estimate that investors could in fact lose $109 billion over 10 years because of the rule's implementation."[66]
- "For example, a Vanguard study from last September shows that having a financial professional's assistance can increase compound annual returns by 300 basis points, fully half of which is due not to investment selection, but to teaching better saving habits and other behavioral changes. Another paper discusses factors the Department did not consider in its analysis, showing the effects a financial professional has in encouraging increased savings and financial discipline. These studies show that the Department underestimated the costs and overestimated the gains of the rule for individual retirement investors—when

these investors lose access to financial professionals, regardless of how they are paid, they lose valuable financial assistance causing real harm."[67]

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