From: Dave Hutchison [mailto:dave@davecfp.com]
Sent: Sunday, July 12, 2015 3:08 AM
To: EBSA, E-ORI - EBSA
Cc: John.Rada@ceteraadvisors.com
Subject: RIN 1210-AB32 Fiduciary Rule

Memo To: e-ORI@dol.gov
Re: RIN 1210-AB32 Fiduciary Rule of DOL
cc: Senator John McCain
Senator Jeff Flake
Representative David Schweikert

I have a CPA firm background and have about 35 years experience in financial planning, investments and especially retirement planning.

In the debate on Fiduciary Rule I believe one issue is totally overlooked.

In most cases unless a customer is an active trader, the fee-only planner with a fee based on assets, is MUCH MORE EXPENSIVE over the long term than implementation via brokerage.

The larger the client, the worse a fee-only (or wrap fee) is over the long-term vs. breakpoints on "A" share mutual funds.

The small client would often just be eliminated by most advisors due to minimum asset sizes required to make economic sense under the more expensive asset-based fee arrangement.

The "Best Interest Contract Exemption" is totally unworkable. It implies that lower cost over the long-term commission compensation is inferior to in many cases the higher long-term costs of asset-based fee investment advice.

FINRA already requires extensive confirmation of suitability, and often we already have zillions of required forms for almost anything an investor does. Now, you suggest another complex contract for IRA recommendations and implementation.

I give advice as an RIA fiduciary for a one-time typically $500 fee.

Since it is usually in the best interest of my clients, I implement via my broker-dealer affiliation - not a usually more expensive wrap fee or "fee only" alternative for the non-trading, long-term investors such as for IRA or ERISA plans.

I have no problem with a uniform fiduciary requirement just not the complex disclosure of the Best Interest Contract.

At investment conferences, I have overheard a number of times a fee-only planner talking to a new advisor that uses commissions. The newbie is often told how much more money they could make over the long-term if the new rep adopts the asset based fee of an RIA vs. broker commissions.

Math

Math is easy a 1% annual advisory fee is equivalent to about a 9% front-end loaded mutual fund over a 10-year period with no increase in the market. Of course if the market goes up, the fee is even higher for a fee only planner.

I did a spreadsheet comparing, for example, a high front-end fee for small investments of an American Funds (AMCAP). I ran for a small $10k investment so at maximum sales charge for a worst case situation with no favorable break-points.

I ran at 3%, 5%, 9% and 12% annual average returns and for 10, 7 and five years.

I compared the total cost of A shares, C shares and F-2 very low annual cost (0.49%) no-load class for advisers adding a typical with a 1.5% annual advisory asset management fee.

Results:

A shares are better than C shares if the holding period is at least seven years. Break-even is about at six years even at lowest 3% annual return. Again this is for the small under $25,000 investor. For higher amounts of investments, the asset based fee is much worse due to better break-points.

C shares are better at five years even at a 12% annual return (and higher 12b-1 fee with higher value/returns).

A and C shares were always better than F-2 shares +1,5% as far as I ran the numbers down to 5 years at 12%.

If someone has $50k or more for fund family, of course, F-2 shares+1.5% asset management fee is more expensive sooner.

Of course, you can also exchange funds within a family at no cost as conditions might change.

Best Interest of Client:

NY Attorney General has gone after in the past fee-only advisory accounts showing the huge extra fees paid by often elderly clients by asset base fees so much greater than the cost if sold as a broker.

Now the DOL wants to encourage investors into an often more expense asset-based fee structure or the horror of the Best Interest Contract.

Especially since 401K's or IRAs are usually not actively traded to justify the savings in commissions.

Low Cost Index Funds
The focus of the DOL seems to be to offer the client the cheapest funds, such as index funds, regardless of performance or risk/reward considerations of historically superior actively managed funds.

I realize the average fund may underperform their comparative index. However, I don't recommend average funds. I recommend funds with managers/teams with a consistent track record of positive Alpha (outperformance) for the risk taken (Beta) in their category with always the "past performance does not assure future results" disclaimer.

Why on earth would you use an index to include stocks that may not have a good outlook, overpriced or whatever JUST because they are part of a cheap index fund or ETF? This makes no sense to me.

Sometimes you get what you pay for. Index funds with no concern of what stocks are included with no selection or research just don't seem to be in the best interest of my clients.

Attachment- pdf file of NY Attorney General Action showing the excess fees paid by asset-based fee vs. brokerage commissions.

Best Wishes
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"Fee Only" Wrap Account Fees Costly if Not an Active Stock Trader
While this is from 2006 it shows the high cost of asset management fees

Press Releases

Office of New York State Attorney General Eliot Spitzer

For Information:
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For Immediate Release
December 12, 2006

STATE LAWSUIT ALLEGES FRAUD IN UBS BROKERAGE ACCOUNTS

Company Illegally Lured Average Investors Into High-Fee Program

Attorney General Eliot Spitzer's office today sued a leading brokerage firm, UBS Financial Services, Inc. (UBS), for defrauding thousands of its customers through its "InsightOne" brokerage program.

The lawsuit details a scheme by UBS to move inappropriate clients from regular brokerage accounts into InsightOne, despite that program's far higher costs for those investors, by falsely promoting InsightOne as providing personalized advice and other financial planning services.

With InsightOne, UBS charged its brokerage customers an asset-based fee instead of per-transaction commissions. But asset-based fee (or "wrap") accounts are inappropriate for investors who rarely trade securities or hold significant amounts of cash, no-load mutual funds, or other similar assets. Rather than steering such investors away from InsightOne, UBS:

- Lured unsuitable investors into the program with false and misleading promises, including the promise of an advice-based account. One UBS broker implored senior executives to "look at our InsightOne brochures and possibly take out the misleading information [relating to advisory services] on the cover;"
- Created a conflict of interest for its brokers by giving them a financial incentive to enroll and keep investors in InsightOne even when the program was ill-suited for those investors;
- Kept many unsuitable investors in InsightOne by encouraging UBS brokers to "churn" their clients' InsightOne accounts – that is, to engage in additional trading for the purposes of surpassing the minimum trading requirement. One broker wrote to a supervisor in an August 2004 email regarding churning, "[N]ow we have to trade heavy or light to stay within guidelines to keep insight one alive …. How Wrong is that? You are not looking at the best interest of the client." The broker continued: "CONFLICT is all over this." Another broker explained to a senior manager in October 2003: "[I]ncreasing transactions in order to comply with this new policy could be detrimental to many clients, which is not something we want to do. Fee based or not, increasing transactions for the sake of increasing transactions (not for the benefit of the client) is called churning."

As a result of UBS's fraudulent conduct, InsightOne customers paid tens of millions of dollars more in InsightOne fees than they would have paid in traditional brokerage account commissions. For example: **[The fees were the result of fee only wrap annual percentage fee compared to the number of trades]**

- UBS charged a 91-year-old InsightOne client more than $35,000 for just four trades over two years – some $33,000 more than she would have paid in a traditional brokerage account.
- Another InsightOne client paid approximately $24,000 in fees in 2003 for executing a single transaction.
- A retiree with an annual income of $11,000 and $56,000 in her InsightOne account paid a fee of $1,250 in 2003 – more than 10% of her annual income – despite trading only twice during the year.
- An 83-year-old investor who had previously made only four trades over two years in her traditional brokerage account, was nonetheless enrolled in InsightOne, where she proceeded to make only four trades over three years, at a cost of $4,300 per trade. In all, she spent almost 8% of her annual income on trading.
- A farming couple made two trades over three years in InsightOne and were charged more than $23,000 per trade, paying some $46,000 more than they would have paid in a traditional account. These fees represented more than 20% of the couple's annual income.

The Attorney General's civil lawsuit was filed today in New York Supreme Court in Manhattan. The lawsuit charges UBS with violations of state anti-fraud laws, as well as common law fraud and breaches of fiduciary duty. The complaint seeks from UBS disgorgement, damages and restitution, as well as injunctive relief.