THE AMERICAN COLLEGE
NORTHWESTERN MUTUAL
GRANUM CENTER
FOR FINANCIAL SECURITY

Submitted Electronically

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

Re: Comments on Department of Labor Conflict of Interest Rule Testimony (RIN 1210-AB32).

Dear Sir or Madam:

Over the past decade I have worked as a Professor of Financial Planning at The American College of Financial Services[1]. I have taught financial service professionals about financial planning, investment strategies, and retirement income techniques. In my role I have had the privilege to work with students from diverse backgrounds. While their business and compensation models often vary, they share a common goal; helping families achieve financial security.

I am writing from a unique perspective as a Professor of Financial Planning at The American College and Director of The Northwestern Mutual Granum Center for Financial Security. As a professor, I have written content for educational courses leading to a number of recognized professional certifications in the financial service industry (ChFC®, RICP®, CLU, AICPA/PFS and CFP® certification). My classroom experience coupled with directing The Granum Center (a research center dedicated to strengthening consumer financial security by strengthening the financial service profession)[2] has compelled me to share my perspectives with you.

I have extensively reviewed testimony presented to the Department of Labor between August 10th to the 13th regarding the proposed conflict of interest rule and believe harm may come to consumers and financial advisers alike if the rule is implemented in its current form. Please consider my comments and questions as you move forward in the rulemaking process.

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1 http://www.theamericancollege.edu
2 http://granum.theamericancollege.edu

The Possibility of Disenfranchising Millions of American Investors is Real if Certain Precautions are not Taken

Testimony from rule advocates and adversaries acknowledged that moving from a current rules-based suitability relationship standard (between financial professionals and IRA owners) to a principal/agency fiduciary relationship will increase costs. On a per-client basis every dollar of new costs incurred by a financial service professional will serve as a disincentive to fostering lower-revenue relationships.

Assume a family is investing $200 per month, or $2,400 annually, and is working with a commission-based financial professional to make ongoing contributions to an IRA. The investor was charged front-end sales loads (5.3%)[3]; which passed to the advisor as a commission. The professional received $127.20 from this relationship over the first year. The family had the benefit of working with a trained and potentially certified agent or broker, who understood asset allocation and risk tolerance.

If adviser costs increase by more than $127.70 per client, they would not have an incentive to continue working with this family Agents, brokers and financial advisers will set their sights on larger investors and leave those investing nominal monthly amounts behind. Alternatively, increased costs may be passed on to consumers, resulting in reduced affordability of services for the Americans who most need financial planning help.

Enforcement costs are one cost component that stands to increase using a principal-based regulation model rather than a rules based one.

Typically, the agreements investment advisers enter into with their customers contain pre-dispute arbitration clauses that provide for private arbitration through the American Arbitration Association (AAA) and the Judicial Arbitration and Mediation Services, Inc. (JAMS), or resolution through litigation in court.

According to the American Bar Association[4], the FINRA arbitration process is generally cheaper than AAA, JAMS or litigation. The costs associated with AAA and JAMS can begin as high as $600 per hour and could cost upwards of $100,000. FINRA charges a flat fee per hearing session at a maximum of only $475 per day. Financial service professionals will be less likely to work with lower

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[3] https://www.ici.org/pressroom/news/13_news_trends_expenses

[4] http://www.americanbar.org/content/dam/aba/images/dispute_resolution/marchenews.PDF

http://www.americanbar.org/content/dam/aba/publications/dispute_resolution_magazine/Gana_Lufrano_TheInconsistentDisputeResolutionProcessforInvestmentAdvisers.authcheckdam.pdf revenue customers as arbitration costs (and in turn liability insurance premiums) begin to soar.

FINRA's suitability rule is relatively straightforward in terms of application and is derived directly from federal and state securities laws, SEC rules and regulations, as well as the FINRA rules and notices to members, which makes rule enforcement more cost efficient.

The fiduciary obligation applied in AAA, JAMS and court for investment adviser and investor disputes with respect to breach of fiduciary duty claims is less straightforward and is derived from a myriad of sources of law, including the Investment Advisers Act of 1940, judicial interpretation of the Advisers Act, as well as SEC rules and regulations.

This fiduciary duty is not easily defined, and includes duties of loyalty and care. Unlike the FINRA rules-based approach, there is no detailed list of prescribed actions to be taken or avoided. As a result, arbitrators in AAA and JAMS are often confused as to the contours of the investment adviser's fiduciary duty or look towards the FINRA rules as guidance for breach of fiduciary duty claims grounded in suitability, communications with customers or supervision.

Some might argue that small-dollar investors could be better served by "robo advice" or by doing their own asset allocation through internet research, but current scholarship does not support this view. In fact, the value of working with a financial advisor significantly reduces costly behavioral finance errors. Robo-advisers do not address the emotional tendency of consumers to make poor decisions about their money, the subjective nature of most input data or use of heuristic techniques (HDSM) to uncover financial goals and dreams.

Qualified, Personal Financial Advice Has Quantifiable Benefits

Academic research consistently supports the value financial planners bring to investment management, goal setting and building client wealth.[5] Financial service professionals provide more than access to products; they also help coach

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[5] Blanchett, D. (2015). The Value of Goals-Based Financial Planning. Journal Of Financial Planning, 28(6), 42-50.

Albright, R., & McDermott, J. B. (2015). Time Perspective and the Practice of Financial Planning. Journal Of Financial Planning, 28(1), 46-52.

Hanna, S. D., & Lindamood, S. (2010). Quantifying the economic benefits of personal financial planning. *Financial Services Review*, 19(2), 111-127.

Martin Jr., T. K., & Finke, M. (2014). A comparison of retirement strategies and financial planner value. *Journal of Financial Planning*, 27(11), 46-53.

and manage client expectations, risk tolerance and behaviors[6]. Financial professionals help keep investors calm when markets dip and rational when they rise. In 2015 the Dow Jones Industrial Average (DJIA) hit a high of 18,300 and to date a low of 15,800, a 13.6% spread. How will disenfranchised IRA owners manage risk and volatility?[7] Will they sell when markets are at their lowest? Will disenfranchised customers act rationally, or trade on emotional impulse?[8] Financial professionals can provide wisdom and answers when the market is on a roller coaster.

Robo-advisers were often suggested as replacements to traditional advisers during testimony, but automated advice does not address client behaviors, risk tolerance, longevity risk, or other significant financial planning challenges. An algorithm managing asset allocation does not keep a consumer from making an impulse purchase or selling when the market is at its worst[9]. The potential to eliminate human advisers for lower- and middle-income families is a risk that cannot be ignored.

Important Questions need to be answered before rules are put in place

The following questions are crucial to both consumers and financial professionals. Their answers will dramatically shape the landscape of financial services for decades to come.

1. Is the fiduciary standard a proxy for product fees and expenses? Will preference be given to exchange traded funds and passive investment vehicles over actively managed funds, and if so, is that the desired outcome?

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[6] Suplee, I. Z., & Dzubow, S. R. (2008). Using Multiple-Criteria Decision Analysis to Simplify the Financial Planning Process. Journal Of Financial Planning, 21(3), 66-75.

[7] Kent Baker, H., & Ricciardi, V. (2015). Understanding Behavioral Aspects of Financial Planning and Investing. Journal Of Financial Planning, 28(3), 22-26.

[8] Barber, B and Oden, T. (2000). Trading stocks is hazardous for your wealth: The common stock investment performance of individual investors. Journal of Finance, 55(2), 773-806

[9] Moisand, D. (2014). Why robo-advisers are a problem for the profession. Journal of Financial Planning, 27(7), 32-33.

Advisers + Technology: better than either alone? (2015). Journal of Financial Planning, 28(1), 22-31.

2. Does the Department of Labor consider investment and insurance products with lower fees superior to those with higher fees? Are other factors (performance, experience, financial strength, management) considered in meeting a fiduciary standard?

3. What is the relationship between insured retirement income products (such as fixed and deferred annuities, mutual funds and money market instruments) and underlying financial strength of the offering company?

   Assume a retiree is in good health and requires guaranteed income. Their primary source of investable assets is an IRA. If a AAA rated insurer can generate an annual guaranteed inflation adjusted income stream of $40 for every $1,000 invested and a B- rated insurer can generate $60 for every $1,000 invested, would both meet a fiduciary standard of care?

4. Surrender charges provide disincentives for consumers to liquidate an investment or insurance product within a short time frame. These disincentives can increase performance by allowing an insurer or Investment Company to choose less liquid products and increase yields. Will products with surrender charges be permitted under the best interest contract exemption? Will a preference be given to investment and insurance products without surrender charges?

5. Has a rigorous rules-based standard (similar FINRA rule 2111) been evaluated as a mechanism of reducing excessive IRA costs and fees?

6. Where will arbitration occur between advisers and consumers? Who will bear the cost of this type of arbitration? Will arbitrating an agency/principal standard be cost prohibitive for financial service firms and their advisors who work mostly with middle and low-income consumers, resulting in potential lack of affordability of advice?

7. Raising the cost of doing business may disenfranchise some IRA owners from working with financial service professionals. Are robo-advisors -- automated tools that do not provide behavioral finance counseling or holistic advice -- better positioned to help low- and middle-income Americans than financial service professionals currently operating under a suitability standard of care?

8. How will lower- and middle-income Americans learn to use automated tools if they are not working with financial service professionals?

These questions illuminate how discerning a fiduciary act isn't as simple as comparing prices. The implementation of a fiduciary standard will hurt low and middle-income investors and result in unknown, expensive and dramatic changes to financial service providers, creating the potential for a significant disservice for American consumers.

Thank you for your consideration. I am happy to discuss this letter in more depth at any time.

Sincerely,

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