Invested in America

September 24, 2015

Mr. Joseph Piacentini
Office Director and Chief Economist
Employee Benefits Security Administration
Department of Labor
200 Constitution Ave, NW, Ste N-5718
Washington, DC 20210
Piacentini.joseph@dol.gov

Dear Mr. Piacentini:

Attached please find a memo from NERA to SIFMA which addresses the questions the Department asked about the NERA study in their letter to SIFMA of August 26th.

Sincerely,

Kenneth E. Bentsen, Jr.
President and CEO
SIFMA

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Memo

To: SIFMA
Date: September 21, 2015
From: Patrick Conroy
Subject: Answers to Questions Regarding NERA's "Comment on the Department of Labor Proposal and Regulatory Impact"

We address the questions raised by Joseph S. Piacenti relating to our "Comment on the Department of Labor Proposal and Regulatory Impact" below.

1) *What are the identities of the financial institutions at which these 63,000 IRA accounts are placed? How many of the fee-based and commission-based accounts, respectively, are placed in each of the financial institutions? Alternatively, please characterize generally how closely these firms represent, or how they differ from, the industry at large.*

   a) The data we collected, including customer account and transaction details, was provided to us under strict confidentiality. For our analysis, we requested data from a number of SIFMA member firms consisting of a variety of standard variables contained in brokerage databases. In response to this request, we received information on over 60,000 accounts. Because firms retain and process their proprietary data to fit their own unique regulatory and business requirements, the data produced by each participating firm differed; therefore, we worked with the relevant variables provided across firms to construct the sample used in our analyses.
   b) We provide a percentage breakout of fee-based vs. commission-based accounts in Exhibit 2 of our report. Approximately 71% of the accounts in our sample are commission-based and 29% are fee-based.
   c) After constructing our data sample, we analyzed the tens of thousands of accounts in the data and confirmed that the sample accounts contained a wide variety of balances, transaction activity levels, and customer ages. Please see our reply to questions 4 and 5 for details.

2) *Please provide a description of the methodology used to select firms for participation in the survey and any other information that might assist in assessing the generalizability of the survey findings.*

We sought to generate a sample of IRA accounts that were maintained under either a brokerage or wrap-fee model. SIFMA representatives arranged communications with member firms that enabled NERA to outline the types of data we were seeking in order to construct such a sample of brokerage data that included both types of accounts. As noted above in answer 1(a), in our conversations with individual member firms, we determined that confidential data would be produced for thousands of accounts. We took this individual firm data and combined it to construct the database used for the analysis.

3) *What criteria were used in selecting IRA accounts for the sample? NERA's report characterizes this set of accounts as "a representative sample of retirement accounts." What population of retirement accounts is this sample believed to be representative of? Is it believed to be representative of all U.S. IRA accounts? What analysis was performed to support the assertion that the sample is representative?*

NERA sought to generate a sample of IRA accounts that was broadly representative of the general population of IRAs. To do so, we asked members to provide us with a random sample of IRA accounts at their firms, where possible. After compiling our sample of over 60,000 accounts from different institutions, we analyzed the distribution of accounts across available dimensions in the data, including characteristics such as account balance, age and trade frequency. This analysis gave us confidence that our data included a diverse selection of accounts, with no evidence of any bias in the data. We provide histograms of several of those variables below.

4) *Please provide raw account-level data in csv format. In the absence of raw data, please provide descriptive statistics, including means and ranges by account type and size, for each variable analyzed in the report, including fee components and returns. Please provide a summary of the characteristics of the IRA accounts, including account balance and asset allocation, by fee structure (fee-based v. commission-based accounts).*

As noted above, the data collected is proprietary and confidential. We provide below additional summary tables in response to questions regarding the distribution of various metrics, where available. In preparing these tables, we ran checks on the underlying data provided by the member firms to ensure its accuracy, including only checked, reliable observations in the metrics.

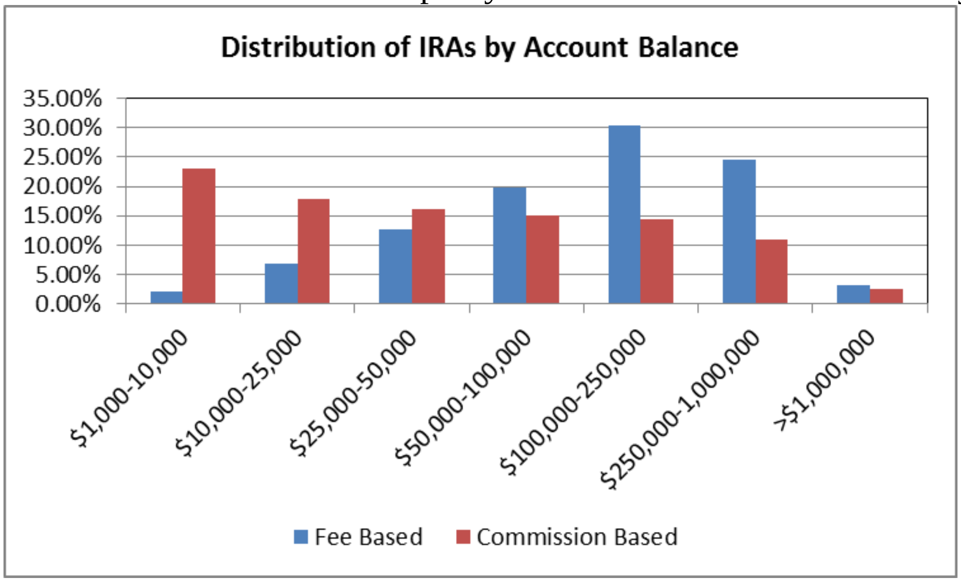
a) Means and quartiles for fees, by account size and type:

2014 Fees								
Account Balance Range	Mean		Median		25th Percentile		75th Percentile	
	Fee Based	Commission Based	Fee Based	Commission Based	Fee Based	Commission Based	Fee Based	Commission Based
$1,000-10,000	1.46%	1.50%	1.36%	0.91%	0.99%	0.33%	1.60%	1.77%
$10,000-25,000	1.19%	0.68%	1.22%	0.48%	0.98%	0.23%	1.49%	0.88%
$25,000-50,000	1.11%	0.57%	1.16%	0.36%	0.88%	0.17%	1.47%	0.73%
$50,000-100,000	1.13%	0.53%	1.20%	0.27%	0.92%	0.12%	1.48%	0.69%
$100,000-250,000	1.19%	0.51%	1.25%	0.24%	0.96%	0.08%	1.49%	0.70%
$250,000-1,000,000	1.07%	0.50%	1.09%	0.22%	0.83%	0.07%	1.43%	0.65%
>$1,000,000	0.92%	0.32%	0.99%	0.12%	0.68%	0.03%	1.18%	0.36%

b) Means and quartiles for quarterly returns, by account type:

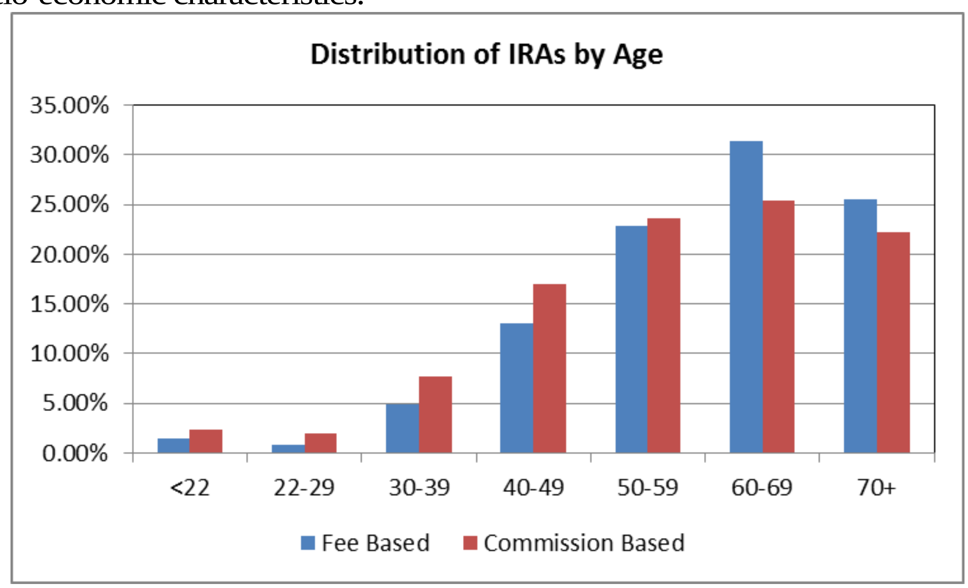
Quarterly Returns								
	Mean		Median		25th Percentile		75th Percentile	
Date Range	Fee Based	Commission Based	Fee Based	Commission Based	Fee Based	Commission Based	Fee Based	Commission Based
Jun-12-Sep-12	4.48%	4.04%	4.36%	4.51%	3.16%	2.58%	5.45%	5.76%
Sep-12-Dec-12	0.17%	0.15%	0.99%	0.36%	-1.16%	-0.93%	1.79%	1.58%
Dec-12-Mar-13	5.75%	6.69%	4.95%	6.91%	3.27%	3.44%	7.81%	9.71%
Mar-13-Jun-13	-0.56%	0.85%	-0.49%	0.41%	-1.76%	-0.90%	0.95%	2.27%
Jun-13-Sep-13	4.91%	4.25%	4.87%	4.25%	3.29%	1.45%	6.44%	6.41%
Sep-13-Dec-13	5.38%	5.34%	5.35%	5.43%	3.81%	2.51%	7.14%	8.24%
Dec-13-Mar-14	1.25%	1.65%	0.99%	1.43%	0.41%	0.26%	1.77%	2.55%
Mar-14-Jun-14	3.53%	3.42%	3.30%	3.48%	2.58%	2.01%	4.17%	4.66%
Jun-14-Sep-14	-1.73%	-0.78%	-1.66%	-0.62%	-2.52%	-1.85%	-0.80%	0.18%
Sep-14-Dec-14	1.27%	1.35%	1.29%	1.25%	0.19%	-0.11%	2.54%	3.17%
Dec-14-Mar-15	1.71%	1.37%	1.69%	1.36%	0.74%	0.00%	2.53%	2.69%

c) A distribution of IRAs in our sample by account balance for each account type:



5) To the extent available, please provide the characteristics of the owners of the IRA accounts, including age, education, and other socio-economic characteristics, by fee structure (fee-based v. commission-based accounts).

We can provide a distribution of accounts by age range of account holders, as of 2015, for fee-based and commission-based accounts. We do not have data on education or other socio-economic characteristics.



6) *The report compares fees in fee-based and commission-based accounts. If possible, provide data on fees omitted from the comparison, such as asset-based fees in fee-based accounts, and, in commission-based accounts, "revenue that the firm may receive indirectly from the account holder, such as mark-up/mark-down revenue or 12b-1 fees." Please provide data on the distribution of fees around the reported medians.*

   Our dataset does not contain information relating to "revenue that the firm may receive indirectly from the account holder, such as mark-up/mark-down revenue or 12b-1 fees." While we would anticipate this may be an area for future analysis, our paper provides a comparison of returns—net of all fees—for fee-based versus commission-based accounts. If different commission based models differentially harmed investors overall, one might expect the impact to be apparent in returns. In contrast, our results suggest that the two types of accounts do not perform differently, which gives insight into the lack of impact of different commission models on performance. Our approach is consistent with some of the academic literature. For example, Christoffersen, et al., one of the main papers used in the DOL analysis, relies on fund level net returns and fees but does not include any data on possible account-level fees or expenses.

7) *The report compares returns in fee-based and commission-based accounts (Table 4), and states that the difference between them is not statistically significant. Please explain what difference was tested for statistical significance. Was it the average of the reported difference in medians across quarters (sample size of 11 quarters)? Did NERA study the difference between fee- and commission-based returns at the account level (sample size of 63,000 accounts), and did such study control for relevant factors, such as risk?*

   We tested the difference between the averages and medians across quarters (with a sample size of 11 quarters). Specifically, for each quarter, we calculated the average (or median) return for fee-based and commission-based IRA accounts. Then, we calculated the difference in the averages (medians) between the account types, and tested to see whether this difference was statistically significantly different from zero using a t-test.

   We did not study the difference between fee- and commission-based returns at the account level.

8) *Table 4 characterizes the statistics presented as "quarterly," implying that the returns have not been annualized. Therefore the average, if expressed in annualized form, would be approximately -1.1 percent. Is that correct?*

   Yes, annualizing quarterly returns of -0.28% yields approximately -1.1%. However, annualizing returns has no impact on statistical significance.