FINANCIAL SERVICES INSTITUTE
VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS AND INDEPENDENT FINANCIAL ADVISORS

VIA ELECTRONIC MAIL (e-ORI@DOL, e-OED@dol.gov)

March 17, 2017

Employee Benefits Security Administration
Office of Regulations and Interpretations
Office of Exemption Determinations
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, DC 20210

Re: Definition of the Term "Fiduciary" and Related Authority and Prohibited Transaction Exemptions – Proposed Delay of Applicability Date (RIN 1210-AB79)

Dear Acting Secretary Hugler:

On March 2, 2017, the Department of Labor (DOL) published its notice of proposed rulemaking regarding the delay of the April 10, 2017 applicability date (Applicability Date) regarding the revised definition of the term "fiduciary" under the Employee Retirement Income Security Act of 1974 (ERISA) and section 4975 of the Internal Revenue Code of 1986 (Code) and related prohibited transaction exemptions (the Fiduciary Rule or the Rule). The DOL proposes to delay the Applicability Date of the Fiduciary Rule from April 10 until June 9, 2017, to facilitate its ability to respond to the President's memo to DOL[1] which, among other things, requires the DOL to revisit the legal and economic analysis originally submitted with regard to the Fiduciary Rule to take into account certain core principles of financial regulation and related issues.

The Financial Services Institute[2] (FSI) appreciates the opportunity to comment on this proposal. We support the proposed delay as a responsible regulatory action in light of the February 3, 2017 Executive Order[3] and Presidential memo to the DOL (together, the Directive).

Background on FSI Members

The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the US, there are approximately 167,000 independent financial advisors, which account for approximately 64.5% percent of all

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[1] Presidential Memorandum on the Fiduciary Duty Rule, February 3, 2017, https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-memorandum-fiduciary-duty-rule.

[2] The Financial Services Institute (FSI) is an advocacy association comprised of members from the independent financial services industry, and is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has been working to create a healthier regulatory environment for these members so they can provide affordable, objective financial advice to hard-working Main Street Americans.

[3] Presidential Executive Order on Core Principles Regulating the United States Financial System, February 3, 2017, https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-executive-order-core-principles-regulating-united-states

producing registered representatives.[4] These financial advisors are self-employed independent contractors, rather than employees of the Independent Broker-Dealers (IBD).

FSI's IBD member firms provide business support to independent financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions. Independent financial advisors are small-business owners with strong ties to their communities and who know their clients personally. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans. Their services include financial education, planning, implementation, and investment monitoring. Due to their unique business model, FSI member firms and their affiliated financial advisors are especially well positioned to provide Main Street Americans with the financial assistance, products, and services necessary to achieve their investment goals.

FSI members make substantial contributions to our nation's economy. According to Oxford Economics, FSI members nationwide generate $48.3 billion of economic activity. This activity, in turn, supports 482,100 jobs including direct employees, those employed in the FSI supply chain, and those supported in the broader economy. In addition, FSI members contribute nearly $6.8 billion annually to federal, state, and local government taxes. FSI members account for approximately 8.4% of the total financial services industry contribution to U.S. economic activity.[5]

I. Summary of FSI's Position

It is self-evident that a delay is essential to the DOL's study of the Rule. The Directive raises substantial issues of law and public policy, and the DOL's study will be a serious and involved undertaking. Public comments to inform that study are not due until April 17 – a week after the current Applicability Date – and, if past is prologue, will be voluminous and express a range of views. That commentary will include new and additional information, garnered from the experience over the last eleven months of implementing the Rule, which the DOL will need to consider. As the DOL stated in its March 2 preamble, the potential results of that study range from the Rule taking effect as written, to revocation or material modification of the Rule. If the Rule is allowed to take effect on April 10, any changes to the Rule after that date will cause confusion for retirement investors, disruption in the financial services industry, and more costs to the retirement system that ultimately will be borne by consumers. In these circumstances, there is only one appropriate course of action: responsible governance requires that the Applicability Date be delayed pending the outcome of the study. Furthermore, FSI supports a delay of more than 60 days -- and at least 180 days -- to allow adequate time for the DOL's study to be developed.

An economic impact analysis also justifies that delay. For the reasons discussed more fully below:

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[4] The use of the term "Financial advisor" or "advisor" in this letter is a reference to an individual who is a registered representative of a broker-dealer, an investment adviser representative of a registered investment adviser firm, or a dual registrant. The use of the term "investment adviser" or "adviser" in this letter is a reference to a firm or individual registered with the SEC or state securities division as an investment adviser.

[5] Oxford Economics for the Financial Services Institute, The Economic Impact of FSI's Members (2016), available at http://www.financialservices.org/uploadedFiles/FSI_Content/Advocacy_Action_Center/DOL/FSI-OE-Economic-Impact-Study.PDF

- A delay would avoid expending additional unnecessary costs in the event there is an ultimate change in the Rule;
- A delay would avoid or reduce start-up costs, in general;
- A delay would avoid additional related costs; and
- The costs to consumers of delay are overstated.

II. Cost-Benefit Justifications for the Delay

The DOL invited comments as to whether the benefits of the proposed 60-day delay, including the potential reduction in transition costs should the DOL ultimately revise or rescind the Fiduciary Rule, justify any costs such as potential losses to affected retirement investors. A delay of the current implementation date is, on balance, not only justifiable, but absolutely imperative, for three key cost-related reasons: the potential for unnecessary outlays given the uncertainty surrounding the status of the Rule; the extraordinary start-up costs associated with meeting the Applicability Date; and the outsized costs that our members currently face during the initial days of implementation of the Rule.

A. Delay Avoids Expending Additional Unnecessary Costs in the Event of an Ultimate Change in the Rule

Our members are currently in an untenable position with respect to their business planning; the lead time to bring relationships with representatives and product providers, compensation and compliance systems, technology and other business processes into line with the Fiduciary Rule is substantial, and the costs greatly exceed the DOL's projections in the Regulatory Impact Analysis (RIA).

Our members are incurring substantial costs which may prove unnecessary depending on the ultimate outcome of the Rule. The costs incurred already are substantial, and will continue to accumulate through 2017 absent a further extension.

- The DOL itself, in its RIA, estimated the cost to comply with the Rule will be between $10 billion and $31.5 billion over ten years, with the most likely figure being $16.1 billion. The DOL itself expects **$5 billion in first-year costs** and $1.5 billion in annual costs after that.
- The Oxford Economics report commissioned by FSI (Oxford Report) and submitted to the DOL last fall warned that the DOL's RIA "dramatically underestimated" the cost to comply with the Fiduciary Rule and that smaller firms would find it difficult to stay in business once the Rule takes hold.[6]
- The Oxford Report estimated that the Rule would result in startup costs ranging from **$1.1 million to $16.3 million per IBD firm,** depending on firm size. Broker-Dealers and investment advisors would be forced to either substantially change

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[6] See Oxford Economic Report on the impact of the DOL Fiduciary Rule, available at http://www.financialservices.org/uploadedFiles/FSI_Content/Advocacy_Action_Center/DOL/FSI-OE-Economic-Impact-Study.PDF. Note, FSI and Oxford Economics will be updating this data for the economic analysis ordered by the Presidential directive.

their current business models or navigate the challenging demands of a best interest contract exemption per the report.[7]

Even the Oxford Report underestimated the actual start-up costs, which are staggering. As reported in industry media:

- One national broker-dealer spent **$28 million** in its 2016 fiscal year on compliance with the Fiduciary Rule.[8]
- Another national firm with a network of 10,000 financial advisors spent **$11 million** on compliance activities during the first half of 2016 alone.[9]
- A major financial services enterprise with substantial broker-dealer operations commented that it will likely spend **between $18 million and $24 million over 2016 and 2017**, and then an additional $5 million to $10 million, once the Rule is fully in effect. [10]
- Another independent broker-dealer with over 2,000 independent registered representatives expects to spend **$10 million** by April 2017 if there is no delay.[11]
- Other firms reported spending **millions of dollars <u>each quarter, starting in 2016,</u>** to become compliant.[12]

B. <u>Delay Avoids or Reduces Start-Up Costs, in General</u>

The DOL correctly noted that a 60-day delay could defer or reduce start-up compliance costs, particularly in circumstances where more gradual steps toward preparing for compliance are less expensive. The DOL requested comment, including data that would contribute to estimation of such impacts. The following costs could be reduced or eliminated by the delay:

- Best Interest Contract Exemption (BICE) Transition Notices: Many of our members have not yet sent out BICE transition notices because of the uncertainty surrounding the future of the Rule. If there is no delay, they will have to incur greatly increased last-minute mailing costs – in some cases, exceeding $1 million per firm. If there is no delay, and if there is a subsequent change to the Fiduciary Rule by the DOL, the entire industry will need to expend the costs to send out transition or other notices about that change.
- Outside Contractors for BICE Compliance: Members are hiring outside consultants, legal advisors, and contractors to enable them to meet the extremely tight timeframe they have been given to come into compliance. With a delay, providers may be able to spread these costs out or avoid them entirely.
- Training and Educational Programs: Because the Fiduciary Rule sets forth a new standard for many financial advisors, our members have been working on developing training programs. They have also been developing materials to help financial advisors explain the changes to their retirement clients. To date, many of our

[7] *Id.*
[8] http://www.investmentnews.com/section/video?playerType=INTV&bctid=5288954879001&date=20170126
[9] *https://www.finextra.com/blogposting/13139/what-it-costs-to-comply-with-the-dol-fiduciary-rule*
[10] *Id.*
[11] *Id.*
[12] *Id.*

members have experienced client frustration or outright resistance to these changes, particularly when a financial advisor recommends that the client move a retirement account from a commission-based account to an advisory arrangement. More time for education of plan sponsors and retirement investors thus is critical. These changes are even more substantial for those members contemplating the use of the BICE, as training and education must include new policies, procedures, business relationships, and methods of compensation.

- BICE Compliance Officer: Some members are in the process of hiring new individuals to fill the role of BICE compliance officer. A delay avoids this expenditure unless and until necessary.

More generally, IBD firms will continue to incur start-up costs throughout 2017. As representatives of the DOL have acknowledged in public comments about the "compliance assistance" approach it will initially follow,[13] compliance with the Rule is a process that will continue beyond the Applicability Date. That in part reflects the Rule itself; as intended, many of our members are planning to make use of the transition period under the BICE (Transition Period) to fully build out compliance processes and systems. It also reflects the financial and practical impossibility for some of our members of coming into full compliance with every aspect of the Rule in the time allowed. We anticipate that spending in the industry on compliance with the Rule will continue at substantially the same pace in 2017 as in 2016. That is, our members' costs are not fully "sunk."

C. Delay Avoids Additional Costs

The DOL correctly noted that beyond start-up costs, the delay would likely relieve the industry of relevant day-to-day compliance burdens. In the absence of a delay, general compliance costs must begin by the Applicability Date and will be ongoing. This is a certainty. Even more costly, however, are the potential costs of class action ERISA litigation, which can be anticipated to begin shortly after the Applicability Date, with further litigation costs mounting if and when the requirements of the BICE later take effect.

1. Ongoing Compliance Costs

Compliance with the Fiduciary Rule will require ongoing expenditures. These include, but are not limited to the following costs:

- Record keeping costs (including the six-year retention requirement contained in the BICE);
- Implementation costs of Best Interest Contracts for both new and existing clients;
- Supervisory, compliance and legal oversight costs;
- Systems development and maintenance costs;
- Ongoing training, education, and licensing costs;
- Increased costs associated with litigation risk management.

The DOL estimates associated savings of $42 million during a 60-day delay. These savings are substantially derived from forgone on-going compliance requirements related to the

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[13] See generally Field Assistance Bulletin 2017-01 (March 10, 2017) available at https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2017-01

transition notice requirements for the BICE, data collection to demonstrate satisfaction of fiduciary requirements, and retention of data to demonstrate the satisfaction of conditions of the exemption during the Transition Period. Similarly, the DOL estimates that small entities would save approximately $38 million in compliance costs due to the proposed 60-day delay of the Applicability Date for the final Fiduciary Rule and exemptions.

Even by the DOL's estimates, a delay in the Fiduciary Rule would be cost effective. However, reported ongoing compliance costs numbers present an even stronger case for delay:

- 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.[14]
- Hardest hit will be IBDs, who stand to lose $4 billion in revenue, or 22%, of the industry's total, per the study, which was released in August. IBDs are also expected to see a decline of $350 billion in client assets, or 11% of the industry's total.[15]
- The Oxford Report estimated that the Rule would cost IBD firms and clients nearly $3.9 billion in total startup costs. SIFMA estimated that compliance costs for their members could range from $240 million to $570 million per year over ten years, or $2.4 billion to $5.7 billion.[16]
- According to a published report, one national broker-dealer expects to spend between **$4 million and $5 million every year** to keep compliant with the Rule, in addition to the $8 million in start-up costs it expects to incur by the end of 2017.[17]

2. Additional Costs

In addition to the savings on compliance costs, the delay avoids costly consequences for IBD firms, financial advisors, and their clients, which would be unnecessary in the event the Fiduciary Rule is eventually modified or revoked.

Industry Restructuring. The industry is already restructuring due to the Rule, with firms consolidating or discontinuing operations because of the costs and exposures created by the Rule.[18] Jobs will be lost – financial advisors will leave the business due to reduced incomes or liability exposure, small firms will be particularly at risk, and financial services innovation (and the job creation it engenders) will be stifled.

Even before the Applicability Date, the Fiduciary Rule has been changing the marketplace for investment services to retirement investors. The investment services available to small retail investors are already shrinking, and will continue to contract.[19] These systemic changes, which

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[14] See http://www.investmentnews.com/article/20160921/FREE/160929978/dol-fiduciary-rule-to-cost-the-securities-industry-11b-by-2020-study
[15] *Id.*
[16] *Id.*
[17] See https://www.finextra.com/blogposting/13139/what-it-costs-to-comply-with-the-dol-fiduciary-rule
[18] See, e.g., *http://www.investmentnews.com/article/20151118/FREE/151119912/dol-fiduciary-rule-could-decimate-number-of-ibds.*
[19] See, e.g., *http://www.valuewalk.com/wp-content/uploads/2016/11/Fiduciary-rule-Press-Release-%E2%80%93-CoreData-Research.pdf* (study indicated Fiduciary Rule will leave mass market investors stranded).

have already been seen in the industry but are expected to continue, should be avoided, particularly when the future of the Fiduciary Rule is uncertain.

Litigation Costs. As the Rule clearly is intended to be enforced through private litigation, the DOL requested comments on class action lawsuits, and in particular, their potential for abuse and the outcome of such cases for plan participants. As a point of reference, ERISA class action litigation has been increasing in recent years, and even meritless suits are expensive to defend. 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.[20] With these costs, it may make financial sense for a company to settle even where there has been no wrongdoing. Without a delay, our members will be exposed to the costs of ERISA class actions, particularly devastating to small firms with more limited resources, before the DOL has had the opportunity to address the Directive, and even greater litigation costs later if and when the BICE's requirements take effect.

The BICE would subject financial advisors to a myriad of actions and potential remedies under the various laws of fifty different states. This contrasts with ERISA's carefully reticulated preemption structure which is intended to avoid subjecting parties to this very issue. Securities laws have similar remedial structures to prevent this result. This problem is directly within the purview of the Directive and therefore presents an additional compelling reason for the delay.

Effects on the Capital Markets. The Rule already is having and will continue to influence our national capital markets – a shortening of the shelf of products and services available to retirement investors, a shift away from classes of appropriate retirement investments that are creating a greater risk of fiduciary exposure, an acceleration in the trend towards passive management of investments, and (as noted above) further consolidation in the financial services industries.[21] These effects have costs that should more fully be understood before the Rule becomes legally applicable.

D. Consumer Costs of Delay are Overstated

The estimated costs to clients of the delay are derived from the estimated gains for these consumers as a result of the Fiduciary Rule. The DOL solicited comments on the degree to which this basis results in an overstated or understated concern about the potential negative effect of the proposed delay on retirement investors.

The DOL correctly notes that the estimated cost to consumers of the delay is entirely speculative, while the costs to the industry are a relative certainty. In addition, we question the ability to use the predicted long-term gains, even if reliable (which as explained below they are not), to extrapolate gains for a 60-day period. This is simply because:

- Investment gains and losses are fluid and not fixed, and in the short-term are unpredictable; and

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[20] Available at http://www.lockton.com/insights/post/fiduciary-liability-claim-trends.
[21] *See*, http://www.business2community.com/brandviews/seismic/now-dol-fiduciary-rules-stakeholders-

- The long-term consequences of the Rule for retirement investors projected in the RIA, even if correct, will not be realized in the second quarter of 2017, due to the BICE transition period and the ongoing process of the industry coming into full observance of the Rule.

In addition, as explained in our comment letters to the Rule's proposal, the Oxford Report noted several analytic flaws in the RIA that result in overestimates of the estimated gains to clients by the proposal. FSI will address the RIA in more detail during the 45-day comment period, but the following points are particularly relevant to the overestimate of the potential costs to consumers of the proposed delay:

- The RIA relies on questionable academic studies to support overall gains on more than a trillion dollars in assets invested in a non-homogeneous way;
- It also fails to consider any economic benefit that investors receive by using investment professionals; and
- It does not consider quantitative and qualitative costs on consumers because of the Fiduciary Rule. In particular, it did not consider increased pass-through costs to consumers, the elimination of investor choices, homogenization of investing strategies that will create greater risk for investors and loss of access to commission based accounts that are more appropriate for some clients than fee-based accounts and products.

With predicted gains to clients unquantified – even the March 2 preamble characterizes the data on which the RIA rests as "uncertain and incomplete" – there can be no justification for the continued expenditure of known compliance costs for a Rule which may see substantive changes or outright repeal.

III. <u>Additional Comments Supporting the Proposed Delay</u>

A. Failure to Delay Will Result in Client Confusion

Some members have been hesitant to continue expenditures on compliance after the Directive, not only because of the costs but because of the risk of confusion to clients. A delay during the pendency of the DOL's review will serve to minimize market disruptions caused by the changing regulatory structure.

- As previously discussed, minimum account balances in advisory accounts are rising and consumers' access to investment advisers is being limited – investors with low account balances are being moved to different account types;
- Investment products and compensation structures are being revised to make it easier for companies to comply with the Fiduciary Rule – these efforts will continue and will need to be finalized if the Rule goes into effect, and possibly revised once again;
- Many of our members have not yet communicated changes that will be brought on by the Fiduciary Rule. It is easy to see how the average client will be confused by correspondence announcing changes to their investment products and business relationship (if the Rule becomes applicable), followed by correspondence announcing additional changes being made for yet another new regulatory scheme (if the Rule is rescinded or revised).

B. The DOL's January 2017 FAQ's Created Unanticipated Compliance Challenges.

The breadth and depth of the sub-regulatory frequently asked questions guidance (FAQ) already issued by the DOL only highlights the substantive questions about the Rule that are still outstanding at this late date. As FSI and several other organizations consistently noted during the initial rulemaking process, our members would require a minimum 36 months between the date of publication of the Rule and the Applicability Date to properly implement such a complex new compliance scheme. Notwithstanding meaningful uncertainties, our members currently become legally accountable for implementation of the Rule on the April 10 Applicability Date, and subject to review by arbiters other than the DOL. Further time for the DOL to provide guidance on the Rule and for the industry to operationalize that guidance is more than justified.

More specifically, two positions taken by the DOL in its January 2017 FAQs were unexpected in the industry and, if allowed to stand, create substantial compliance challenges that cannot possibly be addressed by April 10:

- The position in FAQ 4 that assistance with the investment of a required minimum distribution, which by definition occurs outside of any retirement plan setting and after income taxes on the distribution have been paid, can be fiduciary advice even though communications about the distribution itself are not; and

- The position in FAQ 9 and 10 that communications encouraging plan participants to increase contributions can also be fiduciary investment advice.

In addition, the position in the DOL's FAQs for Exemptions, FAQ 12, that certain types of recruitment compensation arrangements may raise issues under the BICE, is problematic not only because of existing contractual obligations but also because there is insufficient time for firms to undertake a total revamping of their recruitment programs.

C. The Delay Should Be Applicable to All Provisions and Exemptions

The DOL asked for comments on an alternative approach of delaying certain aspects of the Fiduciary Rule (e.g., notice and disclosure provisions) while permitting others (e.g., the impartial conduct standards set forth in the exemptions) to become applicable on April 10, 2017. A partial delay will result in the same costs and confusion as no delay. With the status of the Fiduciary Rule itself in question, if for example, the impartial conduct standard goes into effect April 10, and is later replaced with a different standard, financial advisors will be subject to multiple changing standards of care within a short period. This would be senseless and confusing, particularly because the differences in various standards and where each standard applies may be subtle. In any event, our members would still be forced to restructure their sales and distribution practices to comply, then restructure once again.

It is critically important to note also that if the definitional rule takes effect without corresponding exemptive relief, the retirement services industry will simply come to a standstill. Both the definitional rule and all related new amendments to existing exemptions must also be withdrawn for the duration of the delay. This approach avoids the same duplication of costs and compliance efforts on our members, and the negative impact on investors and the retirement industry as a whole that will otherwise take place.

D. The DOL Needs More Time to Adequately Respond to the President's Directive

The DOL also invited comments regarding whether the delay is necessary or if a different delay period would best serve the interests of investors and the industry. FSI strongly agrees that the DOL will need more time – well beyond the April 10 Applicability Date – to respond to the President's Directive. Given the scope of the Directive, the DOL cannot be expected to conduct the comprehensive analysis and report necessary to respond before April 10.

For the DOL's reconsideration of the Rule to be meaningful, an extension of at least 180 days is needed. This delay permits the DOL to review comments that might help inform updates to its legal and economic analysis, including any issues that the public believes were inadequately addressed in the RIA, before the Rule goes into effect. As the DOL has suggested in the March 2 preamble, this delay should be effective immediately upon publication in the Federal Register. If the publication date is after April 10, the delay should apply retroactively. This structure would address the issue identified above concerning potential liability for any gap period between April 10 and the publication date, although it would not prevent the ongoing accumulation of unrecoverable compliance costs before the delay is finalized.

Conclusion

Since 2009, FSI has publicly supported a carefully-crafted, uniform fiduciary standard of care applicable to all financial advisors providing personalized investment assistance to retail clients.[22] This standard of care would require financial advisors to act in the best interest of their clients, consistent with the DOL's intent. FSI supports the creation of a uniform fiduciary standard of care that is a correct and workable standard, reflecting input not only from the DOL but also the Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA). We believe a delay in the Applicability Date for the Rule is necessary and appropriate to achieve that objective. We look forward to working collaboratively with the DOL during this process to ensure access to retirement products and services for all investors.

Thank you for considering FSI's comments. Should you have any questions, please contact me at (202) 803-6061.

Respectfully submitted,

David T. Bellaire, Esq.
Executive Vice President & General Counsel

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22 *See, e.g.*, Letter from David T. Bellaire, Executive Vice President & General Counsel, Financial Services Institute, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission (Jul. 5, 2013) (commenting on Duties of Brokers, Dealers, and Investment Advisors, Release No. 34-69013; IA-3558; File No. 4-606), *available at* https://www.sec.gov/comments/4-606/4606-3138.pdf.